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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

NASSER G. AFSHAR,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRUCE J. ENNIS, JR.
(Counsel of Record)
GEOFFREY P. MILLER
ENNIS, FRIEDMAN, BERSOFF & EWING
1200 Seventeenth Street, N.W.
Suite 511
Washington, D.C. 20036
(202) 775-8100
Counsel for Petitioner

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QUESTIONS PRESENTED

1. Whether the Fourth Circuit erred in holding, contrary to decisions in the Fifth and Eighth Circuits, that an affirmative act of fraud is not a prerequisite to the imposition of civil tax fraud penalties under 26 U.S.C. § 6653(b).

2. Whether the Fourth Circuit erred in holding, contrary to decisions in this Court and in other federal courts, and contrary to 26 U.S.C. § 7454(a), that the taxpayer bears the burden of establishing the validity of claimed deductions in connection with an action seeking to impose civil tax fraud penalties under 26 U.S.C. § 6653(b).

3. Whether petitioner was denied rights under the Due Process Clause of the Fifth Amendment when the Tax Court quashed petitioner's subpoenas to the government for documents, some of which belonged to petitioner and all of which were necessary for his defense, without requiring that the documents be submitted for *in camera* inspection or that the government provide an affidavit showing that it had no such documents or, if it did have such documents, explaining why they could not be produced.

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioner Nasser G. Afshar respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered on October 22, 1982.[1]

OPINIONS BELOW

The order of the Court of Appeals denying petitioner's timely petition for rehearing (App. C at 55a), entered on December 2, 1982, is unreported. The opinion and judgment of the Court of Appeals affirming the judgment of the Tax Court (App. A at 1a-2a), entered on October 22, 1982, is also unreported. The opinion and judgment of the Tax Court (App. B at 3a-54a) is reported at 41 T.C.M. 1489 (CCH 1981).

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[1] The caption contains the names of all parties.

JURISDICTION

The opinion of the Tax Court was filed on May 18, 1981. The judgment of the Tax Court was entered on November 3, 1981. The order and judgment of the Court of Appeals affirming the judgment of the Tax Court was entered on October 22, 1982. The order of the Court of Appeals denying the petition for rehearing and suggestion for rehearing *en banc* was entered on December 2, 1982. Jurisdiction is conferred on this Court by 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution provides, in pertinent part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law. . . .

The relevant sections of the Internal Revenue Code (codified in title 28, United States Code) provide, in pertinent part:

> Sec. 6653. *Failure to Pay Tax.*
>
> * * * *
>
> (b) *Fraud.*—If any part of any underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. In the case of income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a). . . .
>
> Sec. 7454. *Burden of Proof in Fraud, Foundation Manager and Transferee Cases.*
>
> (a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof shall be upon the Secretary.

STATEMENT OF THE CASE

This petition for review of an order and judgment of the Fourth Circuit raises basic questions regarding the civil tax fraud provisions of the Internal Revenue Code —questions that have been decided in conflicting ways by at least four different courts of appeals, and which are now ripe for resolution by this Court. Moreover, this petition raises an important and unsettled question regarding the scope of the Fifth Amendment's due process guarantee: may the government impose fraud penalties on a taxpayer when the government has withheld documents that may be essential to his defense, without submitting the documents for *in camera* inspection, or submitting an affidavit showing that the government has no relevant documents or, if it does have such documents, explaining why they cannot be produced.

Petitioner, a native of Iran, became a naturalized United States citizen in 1952. For some time after his naturalization, petitioner maintained close contacts with the government of the late Shah. However, in the 1960's relations between petitioner and the Shah's government became increasingly strained. By 1967, petitioner had become a leading opponent of the Shah's regime, and was the founder and publisher of the *Iran Free Press*, a prominent anti-Shah newspaper based in Arlington, Virginia.

Documents released in connection with a Freedom of Information Act suit by petitioner confirmed that the Shah was "incensed" by petitioner's activities and had exerted substantial pressure on our government to revoke petitioner's passport and to shut down his newspaper. Because our government was anxious to maintain cordial relations with the Shah, the "matter had been carefully studied but lawyers had concluded that under U.S. laws

there was regrettably no basis for such action."[2] The released documents acknowledge the "heavy volume of official correspondence" between the State Department and the Iranian Ministry of Foreign Affairs regarding petitioner and his anti-Shah newspaper. *See* Joint Appendix to the Court of Appeals in petitioner's FOIA case, *supra* note 2, at 255.

Petitioner has recently learned that some of that correspondence, although not contained in the record of this case, indicates that our government told the Shah "the only way" it could attempt to suppress the *Iran Free Press* or "punish" petitioner was by asserting tax deficiencies and violations against petitioner.[3]

During the years 1958-62, petitioner represented several United States corporations seeking contracts for construction projects in Iran. In connection with these services, petitioner received cash advances and other sums totaling approximately $363,000. App. B at 5a.

On May 4, 1972, the Internal Revenue Service notified petitioner that it had determined tax deficiencies for the

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[2] *Afshar* v. *Department of State* (D.C. Cir. No. 81-1299) (confidential cable from the U.S. Embassy in Teheran to the Secretary of State ("Tehran 03263") dated May 1973, pp. 1 and 3).

[3] Still other documents suggest cooperative efforts between the CIA and SAVAK, the Iranian secret police. For example, on August 9, 1979, the *Washington Post* reported that a classified study proposed by the staff of the Senate Foreign Relations Subcommittee on International Operations revealed that SAVAK had "a plan in early 1977 to murder Nasser Afshar, an Iranian born U.S. citizen who angered SAVAK by taking out ads in U.S. newspapers denouncing the Shah." The *Post* also reported the study's conclusion that the "CIA passed on to SAVAK some of the intelligence it received from the FBI" on petitioner prior to an earlier assassination attempt. (Petitioner was actually kidnapped by SAVAK in 1974, but survived, though seriously injured, when the kidnap vehicle crashed. *See* Joint Appendix to the Fourth Circuit (hereafter J.A.) at 299-300, 314.)

years 1958-62, more than a decade earlier. The IRS also assessed additions to tax on the grounds that all or part of the underpayment was due to fraud and that petitioner had underpaid his estimated tax.

Petitioner believed these assessments, reaching back as much as fourteen years, were prompted by our government's desire to accommodate the Shah's wishes, and he challenged the notice of deficiency by a petition in the United States Tax Court pursuant to 26 U.S.C. § 6213.[4] Petitioner contended that items included in his gross income by the IRS should not have been considered gross income because they were only advances which he used to pay inducements and hotel and travel expenses pursuant to his efforts to win contracts for his American clients. Alternatively, petitioner contended that, even if the amounts received from his clients were properly included in gross income, he had no taxable income for the years in question after deductions for business expenses.

Petitioner testified in the Tax Court that "his lack of documentary evidence" to establish those expenses was "due to the seizure of his business records by the Iranian Secret Police (SAVAK) in 1967, and that such records were turned over to the American Embassy in Teheran, Iran." (App. B at 35a-36a). In order to obtain those records, he requested, pursuant to the Freedom of Information Act (FOIA), that the government produce copies of any files maintained on him in the Embassy. The government acknowledged that Embassy files did contain documents relating to petitioner. It released some of those documents but withheld others in whole or in part under various FOIA exemptions.

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[4] Petitioner does not here challenge the assessment for underpayment of estimated tax. Accordingly, only the tax deficiencies and the fraud penalties are at issue in this petition.

During the trial, petitioners' attorney[5] issued subpoenas to the Department of State, the Federal Bureau of Investigation, the Department of Defense, the Department of Justice, and the Central Intelligence Agency. The subpoenas demanded production of "all documents relating to tax matters of petitioner from 1957 to present, including certified copies of all tax returns for those years . . . ."[6]

Attorneys representing those departments and agencies objected that the subpoenas were overbroad and burdensome, and informally stated to the court that the documents in their possession pertaining to petitioner did not appear to relate the petitioner's tax status.[7]

Petitioner's attorney pointed out, however, that some of the subpoenaed documents would, in fact, be highly rele-

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[5] Petitioner was represented at trial by an attorney who had been retained only two days earlier. *See* J.A. at 295-96. Although petitioner's attorney moved for a continuance based on the fact she had not had an opportunity to review the extensive file, issue subpoenas, or engage in necessary discovery, and indeed had "never even seen the petition" (J.A. at 295), the Tax Court denied the motion and insisted that the case proceed that same day. J.A. at 318.

[6] J.A. at 568. Petitioner also asked the government to admit that copies of his tax returns for the years in question, along with all of his business records and substantiating documentation for his expenses during those years, were confiscated by SAVAK in 1967 and turned over to the United States Embassy in Iran. Petitioner further maintained that the documents were either destroyed by Embassy officials or that those documents were being wrongfully withheld by those officials. J.A. at 570.

[7] For example, the attorney representing the Department of State told the court that a "large number of documents have been released to Mr. Afshar, and those which have not been released, do not appear to relate to his tax status." J.A. at 625. All of the attorneys acknowledged that they did not have personal knowledge of the documents in question. These informal representations that the documents in the government's possession did not appear to relate to petitioner's tax status were not supported by sworn testimony or by a single affidavit.

vant even if they did not appear to be "related to the tax matters." J.A. at 628. She mentioned, as an example, documents which "would indicate registrations by Afshar for these various companies [petitioner's clients] involved in this suit. And therefore, show expenses—some of the main expenses incurred in Iran." J.A. at 628. As petitioner's counsel noted, since the attorneys opposing the subpoenas "are not tax attorneys . . . they may not realize the tax material relationship . . . ." J.A. at 628. Accordingly, noting that there was "only one way to be sure" that the government was not knowingly or unwittingly withholding tax related documents, petitioner's attorney specifically requested that "the undisclosed documents be submitted in camera to Your Honor for Your Honor's office to check through for those types of items I'm talking about." J.A. at 628. But the Tax Court declined to review the documents *in camera*, and quashed the subpoenas.[8]

After finding that petitioner had received gross income of approximately $363,000 during the years in question, the Tax Court addressed petitioner's claim that he had incurred deductible business expenses in an amount sufficient to reduce his tax liability for those years to zero.[9] The Tax Court held that petitioner "*has the burden of*

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[8] J.A. at 588, 592 and 631. *See also id.* at 630-631, in which the Tax Court Judge said "I think, under the circumstances, there's really no need for me to examine these documents . . . and I'm going to rely upon Mr. Gallagher's [the attorney for the State Department] assertion as an attorney that they are not that type of document." The judge quashed all the subpoenas in all respects, except for one subpoena to the Department of Justice, which the judge sustained insofar as it sought production of a file pertaining to an earlier lawsuit involving petitioner.

[9] Although the deductions claimed by petitioner for 1958 and 1959 were less than his gross income for those years, petitioner contended that there would be no tax liability due to a carryback of net operating losses for 1960, 1961 and 1962. *See* 26 U.S.C. § 172.

proving that he is entitled to such deductions" (App. B at 31a) (emphasis added), and concluded that petitioner had failed to meet that burden. With respect to travel, lodging, telephone and entertainment expenses, the court found that the evidence of record provided "little guidance as to what portion of the petitioner's expenditures . . . were incurred for business rather than for personal reasons." The Court found that:

> "the evidence fails to convince us that any additional deductions [beyond those allowed by the Commissioner] were allowable. The receipts offered into evidence by the petitioner fail to show a business reason for the petitioner's expenditures. The only corroboration offered by the petitioner was his own self-serving testimony, which we are not required to, and do not, accept." (App. B at 33a).[10]

The Tax Court also rejected petitioner's claim that he was entitled to deductions for registration fees and legal expenses incurred in Iran on behalf of his clients. The court found that petitioner had "*failed to meet his burden of proving that he paid such expenses.*" (App. B at 38a) (emphasis added). According to the court,

> "The only evidence the petitioner introduced in support of his right to such deductions was his own self-serving testimony. He claims that his lack of documentary evidence is due to the seizure of his business records by the Iranian secret police (SAVAK) in 1967, and that such records were turned over to the American Embassy in Teheran, Iran. He further maintains that officials of the American Embassy either destroyed such records or that officials of the U.S. Government have wrongfully withheld such records despite petitioner's efforts to obtain such records by an action under the Freedom of Information Act." (App. B at 35a-36a).

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[10] The court held in favor of petitioner only with respect to a few minor travel deductions in the amount of $263.12 for 1961 and $152.90 for 1962. App. B at 33a-34a.

The Tax Court rejected petitioner's claimed deductions, holding that "petitioner has *failed to carry his burden of proving that he is entitled to any of the deductions for registration fees and legal expenses.*" App. B at 39a (emphasis added).

The Tax Court next considered whether petitioner was liable for fraud penalties under 26 U.S.C. § 6653(b), which provides that "if any part of any underpayment . . . of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment." The court held that the Commissioner has the burden of proving by clear and convincing evidence that some part of the underpayment for the year was due to fraud. App. B at 39a. To establish fraud, in the court's view, the Commissioner had to show that the taxpayer intended to evade taxes, which he knew or believed he owed, by conduct intended to conceal, mislead or otherwise prevent the collection of taxes. App. B at 39a, citing *Stolzfus v. United States*, 398 F.2d 1002 (3d Cir. 1968), *cert. denied*, 393 U.S. 1020 (1969).

In concluding that the Commissioner had established fraud, the Tax Court focused on three considerations. First, the court held that petitioner had obtained the funds from his clients under false pretenses, and had no intention of repaying the sums advanced or using them for their stated purpose. App. B at 40a-45a. Second, the court found that petitioner had failed to file a tax return for any of the years in issue. App. B at 46a-50a. Third, the court observed that petitioner had been evasive, uncooperative and dilatory during the course of the Commissioner's investigation. App. B at 50a-52a. Accordingly, the court held that petitioner was liable for civil fraud penalties under § 6653(b).

On October 22, 1982, the Court of Appeals for the Fourth Circuit affirmed the judgment "for reasons adequately set forth in the opinion of the Tax Court." App. A at 2a.

Petitioner filed a timely petition for rehearing and suggestion for rehearing *en banc*. Petitioner contended that the Fourth Circuit panel had overlooked an exceptionally important principle of constitutional law—the right not to be deprived of property without due process of law—by placing on petitioner the burden of establishing additional deductions, in circumstances where the evidence (unrebutted by government testimony or affidavit) indicated that the government may have withheld relevant documents, some of which belonged to petitioner, which petitioner needed to meet that burden. The Fourth Circuit denied the petition for rehearing and suggestion for rehearing *en banc* by order entered on December 2, 1982. App. C at 55a.

REASONS FOR GRANTING THE WRIT

I. The Decision Below Conflicts With Decisions In The Fifth And Eighth Circuits In Holding That An Affirmative Act Of Fraud Is Not A Prerequisite To The Imposition Of Civil Tax Fraud Penalties Under 26 U.S.C. § 6653(b).

The decision below affirmed the judgment of the Tax Court for the reasons given in that court's opinion. App. A at 2a. The Tax Court held that petitioner was liable for fraud penalties under 26 U.S.C. § 6653(b) on the basis of three factors: (1) that petitioner had obtained his income under false pretenses; (2) that petitioner had failed to file returns during the years in question; and (3) that petitioner had been evasive and uncooperative during the Commissioner's investigation. The Tax Court did not cite—nor could it have cited—any evidence that petitioner engaged in any affirmative act of misrepresentation or fraud with respect to the taxing authorities. In holding petitioner liable in the absence of such an affirmative act of fraud, the Tax Court and the Fourth Circuit agreed with the Third Circuit that such an affirmative

act is not a prerequisite to liability under § 6653(b). The ruling of the Tax Court and the Fourth Circuit, however, conflicts with holdings on this point by the Fifth and Eighth Circuits.

The Third Circuit rule was established in *Stolzfus* v. *United States*, 398 U.S. 1002 (3d Cir. 1968), *cert. denied*, 393 U.S. 1020 (1969), which upheld an assessment of fraud penalties against a taxpayer, despite the fact that the only evidence introduced by the government was that the taxpayer had failed to file returns for the years in question, that he was aware of his obligation to file tax returns, and that he had a keen awareness of business and financial matters. The Third Circuit explicitly stated that it was not adopting "the criminal law standard that the government must prove an affirmative 'act.'" 398 F.2d at 1005 n.6.

The conflicting rule—that the government must demonstrate an affirmative act of deception of taxing authorities—is derived from this Court's decision in *Spies* v. *United States*, 317 U.S. 492 (1943), a criminal case. The Court held that a taxpayer could not be convicted of the felony of willfully attempting to evade or defeat his federal tax liability when the evidence showed only that the taxpayer had willfully failed to pay the tax or to file a return. According to the Court, "[w]illful but passive neglect of the statutory duty" was insufficient to establish the felony. Instead, "Congress intended some willful commission in addition to the willful omissions." *Id.* at 498.

The *Spies* requirement of a willful and positive act of commission has been adopted in the *civil* tax fraud context by the Eighth and Fifth Circuits.[11] In *First Trust*

[11] The rationale of these courts has been the perception that the constituent elements of civil and criminal tax fraud are identical. *See, e.g., Moore* v. *United States*, 360 F.2d 353, 355 (4th Cir. 1965), *cert. denied*, 385 U.S. 1001 (1967); *Plunkett* v. *Commissioner*, 465 F.2d 299, 305 (7th Cir. 1972); *Tomlinson* v. *Lefkowitz*, 334 F.2d 262 (5th Cir. 1964), *cert. denied*, 379 U.S. 962 (1965).

& Savings Bank of Davenport v. *United States*, 206 F.2d 97 (8th Cir. 1953), the Eighth Circuit held that civil fraud penalties were inappropriate when "[t]here was no proof of any willful commission of any affirmative act of fraud on the part of the taxpayer," and where the taxpayer's dereliction "consisted only in willful omission and passive neglect to perform the duty of making returns imposed upon him by law." *Id.* at 99.

The same rule was adopted by the Fifth Circuit in *Jones* v. *Commissioner*, 259 F.2d 300 (5th Cir. 1958), citing *Spies* and holding that the taxpayer could not be held liable for civil fraud penalties when the only evidence against him was that he willfully neglected to file returns and used the money for personal expenditures. *See also Marsellus* v. *Commissioner*, 544 F.2d 883, 886 (5th Cir. 1977) (citing *Jones* for the proposition that "in order to establish civil tax fraud, the government must show both a willful failure to file tax returns *and some independent act of misrepresentation or concealment.*") (emphasis supplied).

In the present case, there was no finding or evidence of any independent act of misrepresentation or concealment by petitioner. The Tax Court's conclusion that petitioner's income was obtained under false pretenses is irrelevant, because § 6653(b) requires fraud or misrepresentation with respect to the taxing authorities, and is not concerned with the private parties with whom petitioner had dealings, or with the source of petitioner's income. That petitioner may have failed to file returns for the years in question is also insufficient to satisfy the affirmative act requirement; at most, it would support an inference that petitioner had willfully *omitted* to file returns. Finally, the Tax Court's conclusion that petitioner failed to cooperate with federal investigators supports, at most, the inference that petitioner engaged in a pattern of neglect or omissions. The Tax Court did not find that petitioner engaged in any misrepresentation or concealment with respect to those officials.

Thus, this case squarely presents the conflict between the Fifth and Eighth Circuits, on the one hand, and the Third and Fourth Circuits, on the other, with respect to whether an affirmative act of misrepresentation or concealment is a necessary prerequisite to liability under § 6653(b). The conflict is one of long standing and involves at least four federal circuits. Accordingly, this Court should grant the petition for a writ of *certiorari* to resolve the conflict.

II. The Decision Below Conflicts With 26 U.S.C. § 7454(a) And With Decisions In This Court And Other Federal Courts In Requiring The Taxpayer To Establish The Legitimacy Of Claimed Deductions In Connection With The Government's Imposition Of Civil Tax Fraud Penalties Under 26 U.S.C. § 6653(b).

Under 26 U.S.C. § 7454(a) the burden is on the government to prove that the "petitioner has been guilty of fraud with intent to evade tax." The Tax Court acknowledged that the government has the burden of establishing that petitioner's conduct was fraudulent. App. B at 39a. The Tax Court held, however, that *petitioner* had the burden of proving the validity of his claimed business deductions. The Fourth Circuit, in endorsing the Tax Court's reasoning, therefore held that in a civil tax fraud case the taxpayer has the burden of proving that he did not have a tax deficiency.

That holding conflicts with the plain language of the relevant statutes. Because § 6653(b) applies only if there is an "underpayment" of tax, it is clear that a tax deficiency is a necessary element of civil tax fraud. And § 7454(a) plainly places on the government the burden of proof with respect to every element of civil tax fraud. Thus, § 7454(a) requires the government to prove the existence of a deficiency. In the present case, the relevant statutes required the government to show that petitioner was not entitled to the claimed deductions. The Tax

Court and the Fourth Circuit misread the plain language of these statutes when they placed on petitioner the burden of proving that he *was* entitled to those deductions.[12]

The Fourth Circuit's decision also conflicts with prior opinions of this Court and the courts of appeals. In *Sansone* v. *United States*, 380 U.S. 343, 351 (1964), this Court held that the elements of the criminal tax fraud felony are: (1) willfulness; (2) the existence of a tax deficiency; and (3) an affirmative act constituting an evasion or attempted evasion of the tax. Because the elements of criminal and civil tax fraud are identical,[13] the *Sansone* case necessarily implies, contrary to the decision below, that the existence of a tax deficiency is an element of civil tax fraud as to which, under § 7454(a), the government has the burden of proof.[14]

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[12] If the Commissioner does not meet his burden of proving that part of the underpayment is due to fraud, the taxpayer cannot be subject to fraud penalties under § 6653(b). The taxpayer might still be liable for back taxes, however, since, absent fraud, the burden of proving the validity of claimed deductions is on the taxpayer.

[13] *See* note 11, *supra*.

[14] In its brief in the court below, the government relied on several cases for the proposition that, even in a criminal tax fraud case, the government does not have to prove taxable income or a tax deficiency. Those cases, however, are entirely distinguishable from the case at bar. Most of the government's cases were not tax fraud cases and are therefore irrelevant. Two cases cited by the government—*United States* v. *Bender*, 218 F.2d 869 (7th Cir. 1955), and *United States* v. *Hiett*, 581 F.2d 1199 (5th Cir. 1978)—were cases in which the government was held to have adduced sufficient evidence to establish a *prima facie* case. They stand for the proposition that once the government has established its *prima facie* case, the taxpayer may have the burden of rebutting that case. They do *not* stand for the proposition that the taxpayer has the burden of disproving a tax deficiency in a fraud case, since the existence of a

The decision below also conflicts with a recent Ninth Circuit case, *Considine* v. *United States*, 683 F.2d 1285, 1286 (9th Cir. 1982), where the court held that "[t]o establish liability for the . . . civil fraud penalty, the government must establish: (1) a knowing falsehood; (2) an intent to evade taxes; and (3) an underpayment of tax." The Ninth Circuit further held that "[a]lthough the burden of proof is usually on the taxpayer in contesting a deficiency, the government has the burden of proof to establish the elements of the civil fraud penalty by clear and convincing evidence." *Id.* at 1286 n.1. The Ninth Circuit's holding that the government has the burden of establishing an underpayment of tax is directly contrary to the holding of the Fourth Circuit that the petitioner had the burden of refuting the claimed deficiency.

The decision below also conflicts with the Fourth Circuit case of *Richardson* v. *Commissioner*, 264 F.2d 400, 404 (4th Cir. 1959). The taxpayer in *Richardson* was a ship chandler who contended he had incurred deductable business expenses by making payments to captains of foreign flag vessels who placed orders with his firm. Although the Fourth Circuit affirmed the Tax Court's finding of a deficiency, it reversed the imposition of civil tax fraud penalties. Noting that "[d]ifferent considerations control the imposition of a fraud penalty than apply to the affirmance of a deficiency," *id.* at 404, the Fourth Circuit rejected the Commissioner's argument that in fraud cases the taxpayer had the burden of establishing his right to deductions. The Fourth Circuit concluded that the Commissioner had failed to carry his burden of proving that there was a deficiency and that the deficiency was due to fraud.

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tax deficiency is part of the government's *prima facie* case. The government's argument that it does not have the burden of proof is particularly surprising since its own *Manual for Criminal Tax Trials* appears to be to the contrary. *See* Department of Justice, *Manual for Criminal Tax Trials* 65.

Finally, the decision below conflicts with the views of both the majority and dissenting Tax Court judges in *Goodwin* v. *Commissioner*, 73 T.C. 215 (1976). Each of the opinions in that case recognized either explicitly or implicitly that in a civil tax fraud case the burden is on the government to prove an underpayment of tax.

Because of these conflicts, some taxpayers will be found liable for civil tax fraud penalties, and others, similarly situated, will be found not liable. Such disparate results in an area as sensitive as the taxing power should not be tolerated. Accordingly, this Court should grant the petition for a writ of *certiorari* in order to resolve the conflict.

III. The Decision Below Raises An Important And Unsettled Question of Constitutional Law: Whether The Due Process Right Of Discovery Against The Government Established By This Court In Criminal Cases Extends To Litigants In Civil Tax Fraud Cases That Are Quasi-Criminal In Nature.

In *Brady* v. *Maryland*, 373 U.S. 83, 87 (1963), this Court held that in a criminal case "suppression by the prosecution of evidence favorable to an accused . . . violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution." In *Wardius* v. *Oregon*, 412 U.S. 470 (1973), this Court held that states applying a "notice-of-alibi" rule in criminal cases must, under the Due Process Clause, provide reciprocal discovery rights to the accused. These and other cases establish that, although there is no general right of discovery against the government in criminal cases, *Weatherford* v. *Bursey*, 429 U.S. 545 (1977), the Due Process Clause does guarantee rights of discovery in certain situations.[15]

[15] The holdings in *Brady* and *Wardius*, although technically based on the Due Process Clause of the Fourteenth Amendment, are binding against the federal government under the Fifth Amendment's Due Process Clause. *See, e.g., United States* v. *Agurs*, 427 U.S. 97 (1976).

This Court has apparently never considered whether citizens involved in *civil* litigation against the government enjoy any discovery rights under the Due Process Clause. There is, however, no reason in principle why the Due Process Clause would not apply in the civil discovery context. Indeed, several lower federal courts have recognized that denial of discovery to civil litigants can amount to a denial of due process. *See, e.g., Application of Eisenberg*, 654 F.2d 1107, 1112 (5th Cir. 1981) ("the right granted a party by the due process clause to a full and fair hearing encompasses the individual's right to be aware of and refute the evidence against the merits of his case"); *McClelland* v. *Andrus*, 605 F.2d 1278, 1286 (D.C. Cir. 1978) ("to deny appellant access to the results of [a government investigation] could do violence to our conception of fair procedure and due process"); *NLRB* v. *Valley Mold Co.*, 530 F.2d 693 (6th Cir.), *cert. denied*, 429 U.S. 824 (1976); *J.H. Rutter Rex Manufacturing Co.* v. *NLRB*, 473 F.2d 223 (5th Cir.), *cert. denied*, 414 U.S. 822 (1973); *Electronic Design & Development Co.* v. *NLRB*, 409 F.2d 631 (9th Cir. 1969); *United States* v. *Dillman*, 146 F.2d 572, 574 (5th Cir. 1944), *cert. denied*, 325 U.S. 870 (1945) ("due process includes the right of each party to be appraised of all the evidence upon which the adjudication will rest, plus the right of each party to examine, explain or rebut all such evidence"); *Standard Oil Co.* v. *FTC*, 475 F.Supp. 1261, 1275 (N.D. Ind. 1979).

This case provides an opportunity to consider the scope of due process discovery rights in a civil lawsuit that is analogous, in many respects, to a criminal prosecution. The petitioner was a private citizen in litigation against the government. The information sought was in the hands of the government rather than a private party. And, most importantly, the cause of action in this case—civil tax fraud—is closely related to the criminal tax fraud offense. The elements of criminal and civil tax fraud

are identical, the only difference between the two being the quantum of proof involved. *See* cases cited in note 11, *supra*. A taxpayer found liable for civil tax fraud is subject to sanctions and collateral consequences that closely resemble those resulting from a criminal tax fraud conviction: the taxpayer is subject to a penalty, similar to a fine, in the amount of 50% of the tax liability, and suffers a stigma not unlike that arising out of conviction for criminal fraud.

Because this case is closely related to a criminal prosecution, and could even be considered a quasi-criminal proceeding, it provides an appropriate vehicle for the Court to consider whether and to what extent due process discovery rights developed in the criminal context apply in civil cases.[16]

Moreover, in one respect the due process concerns in the present case may be more substantial than in a criminal case. The prosecution in a criminal case must establish each element of the offense with proof beyond a reasonable doubt. *Sandstrom* v. *Montana*, 442 U.S. 510 (1979); *In re Winship*, 397 U.S. 358 (1970). As applied to tax fraud, this requirement means that the federal government must prove beyond a reasonable doubt that the defendant earned taxable income during the years in

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[16] In at least one other context in which this Court has extended rules developed in criminal cases to the civil area, the Court has found it useful to consider the effect of the rules on civil cases that are closely related to criminal cases before moving gradually to cases with fewer and fewer connections with the criminal law. *See, e.g., Younger* v. *Harris*, 401 U.S. 37 (1971) (federal courts will generally not interfere with pending state criminal proceedings); *Huffman* v. *Pursue, Ltd.*, 420 U.S. 592 (1975) (*Younger* extended to state-initiated civil proceedings in aid of and closely related to state criminal statutes); *Judice* v. *Vail*, 430 U.S. 327 (1977) (*Younger* applied to state civil contempt proceedings); *Trainor* v. *Hernandez*, 431 U.S. 434 (1977) (*Younger* applied to state-initiated suits seeking return of wrongfully-withheld welfare payments).

question. Accordingly, in a criminal case the government would have the burden of proving beyond a reasonable doubt that the sums advanced to petitioner were income to petitioner and were not used, as petitioner claimed, to cover the expenses of seeking contracts for petitioner's clients.

In the present case, in contrast, the Tax Court held—erroneously, we believe, *see* Point II *supra*—that the burden was on petitioner to establish the legitimacy of his claimed expenses. This allocation of the burden of proof made it absolutely essential for petitioner to obtain his records from the government in order to prove his defense. Yet, in the absence of any due process constraints on its action, the government would have no incentive to disclose documents in its possession that tended to substantiate petitioner's claims. It was fundamentally unfair to place on petitioner the risk of non-persuasion and at the same time allow the government, as opposing party, to withhold documents petitioner claimed were essential to his defense. In these circumstances, the Due Process Clause necessarily provides at least some protections to private citizens in litigation with the government.[17]

Petitioner does not assert that his right to discovery is unqualified. Due process is a flexible concept; even when it is applied, the question remains what process is due. *Matthews* v. *Eldridge*, 424 U.S. 319 (1976). A litigant's interest in discovering information relevant or even essential to his case must sometimes yield to strong countervailing interests. For example, the government has an interest in protecting state secrets, *see United States* v. *Reynolds*, 345 U.S. 1 (1953), and in ensuring the privacy of its deliberative processes, *see United States* v. *Nixon*, 418 U.S. 683 (1974). Similarly, the sound public policies

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[17] If the judgment of the Court of Appeals is allowed to stand, petitioner will obviously be deprived of a "property" interest cognizable under the Due Process Clause.

underlying the work-product doctrine and other litigation privileges may limit what a party can discover of facts known by an opposing party. *See, e.g., Hickman* v. *Taylor*, 329 U.S. 495 (1947); *Goldberg* v. *United States*, 425 U.S. 94 (1976).

Petitioner *does* contend, however, that the government was required either to submit the documents in its possession for *in camera* inspection, or to file an affidavit showing that the government did not have any tax-related documents relevant to petitioner's case or, if it did have such documents, explaining why those documents could not be produced.

The government should first have prepared an index specifically describing the documents in its possession covered by petitioner's discovery request. *Cf. Vaughn* v. *Rosen*, 484 F.2d 820 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 977 (1974) (Freedom of Information Act). Documents the government believed were privileged should have been submitted to the Tax Court for *in camera* inspection. *Cf. United States* v. *Nixon*, *supra* (*in camera* inspection of evidence relevant to ongoing criminal prosecution). If submitting the documents for *in camera* inspection was not feasible or would have posed an unwarranted danger to national security, the government should at least have provided an affidavit from responsible agency officials to that effect. *Cf. United States* v. *Reynolds*, *supra* (assertion of state secrets privilege in litigation must be accompanied by affidavit by head of agency or department involved).

Petitioner believes he was denied due process of law when his subpoenas were quashed without any such showing by the government. This Court should grant the petition to consider whether the Due Process Clause provides at least limited discovery rights to private parties in civil litigation against the government, and, if it does, whether petitioner was accorded the degree of procedural protection that was due under the circumstances.

CONCLUSION

The petition for a writ of *certiorari* should be granted.

Respectfully submitted,

BRUCE J. ENNIS, JR.
(Counsel of Record)
GEOFFREY P. MILLER
ENNIS, FRIEDMAN, BERSOFF
& EWING
1200 Seventeenth Street, N.W.
Suite 511
Washington, D.C. 20036
(202) 775-8100
Counsel for Petitioner

Dated: February 28, 1983

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 82-1095

NASSER G. AFSHAR,
Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

Appeal from a decision of the United States Tax Court
Charles R. Simpson, Judge

Argued October 6, 1982 Decided October 22, 1982

Before BUTZNER and PHILLIPS, Circuit Judges,
and HAYNSWORTH, Senior Circuit Judge

Scott P. Crampton (Bogan & Freelan; James Dewey O'Brien on brief) for appellant; Elaine F. Ferris, Tax Division, Dept. of Justice (Glenn L. Archer, Jr., Assistant Attorney General; Michael L. Paup, Carleton D. Powell, Tax Division, Dept. of Justice on brief) for appellee.

PER CURIAM:

Nasser G. Afshar petitioned the United States Tax Court for a redetermination of certain deficiencies in, and additions to, his federal income taxes for the years 1958

to 1962. Following a three-day trial, the Tax Court filed a memorandum opinion,[1] which in general sustained the Commissioner's determination of deficiencies. It also found Afshar liable for additions to tax for civil fraud under 26 U.S.C. § 6653(b) and failure to pay estimated taxes under 26 U.S.C. § 6654. Afshar appeals from this decision.[2]

We conclude that the Tax Court rightly allocated the burden of proof on the elements of civil fraud. We also conclude that the Tax Court properly accepted the stipulation of facts. Finally, the court fully complied with rule 90 of its Rules of Practice and Procedure when it admitted into evidence the Commissioner's request for admissions. The judgment is affirmed for reasons adequately set forth in the opinion of the Tax Court.

AFFIRMED.

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[1] *See* T.C.M. (P-H) ¶ 81,241 (1981).

[2] In his appeal, Afshar does not contest the Tax Court's finding of liability under 26 U.S.C. § 6654 for failure to pay estimated taxes.

APPENDIX B

T.C. Memo. 1981-241

UNITED STATES TAX COURT

NASSER G. AFSHAR,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 6099-72. Filed May 18, 1981.

During 1958 through 1962, P represented himself to various U.S. companies as a person of influence in obtaining contracts with the government of Iran. Based on P's representations, such companies "advanced" money to P to secure contracts. P did not render services on behalf of such companies, and P never repaid the funds advanced to him. During such period, P claimed to have incurred business expenses on behalf of such companies in excess of the funds he received. Also, during such period, P did not file Federal income tax returns or make estimated tax payments. *Held*, the amount of P's deductible business expenses determined. *Held, further*, P received gross income from swindling during each of the years in issue, and P's failure to file returns and report such income was due to fraud. *Held, further*, P is liable for the penalty for failure to pay estimated tax imposed by sec. 6654, I.R.C. 1954.

Helen E. Marmoll, for the petitioner.

Ruud L. Duvall, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SIMPSON, *Judge*: The Commissioner determined the following deficiencies in, and additions to, the petitioner's Federal income taxes:

Year	Deficiency	Additions to Tax	
		Sec. 6653(b) I.R.C. 1954 [1]	Sec. 6654 I.R.C. 1954
1958	$73,250.18	$36,625.09	$2,047.04
1959	15,001.61	7,500.81	415.04
1960	45,489.89	22,744.95	1,267.67
1961	21,188.58	10,594.29	587.23
1962	21,867.73	10,933.87	605.98

The issues for decision are: (1) Whether the petitioner incurred business, travel, and entertainment expenses in excess of the amounts allowed by the Commissioner; (2) whether there was any underpayment of tax due to fraud within the meaning of section 6653(b); and (3) whether the petitioner is liable for additions to tax under section 6654 for underpayment of estimated taxes.

FINDINGS OF FACT

Some of the facts have been stipulated, and those facts are so found.

The petitioner, Nasser G. Afshar, resided in Alexandria, Va., at the time he filed his petition in this case. The petitioner was born in Teheran, Iran. He became a naturalized citizen of the United States in 1952, and since that time, he has resided in the United States. He is married to a native-born U.S. citizen. During the years in issue, 1958 through 1962, the petitioner lived with his wife and children in Glen Ridge, N.J. Since 1969, the petioner has resided in Virginia.

The petitioner stipulated that during the years in issue he received gross income from the following persons in the amounts shown:

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[1] All statutory references are to the Internal Revenue Code of 1954 as in effect during the years in issue.

Payor	1958	1959	1960	1961	1962
Fluor Corporation, Ltd.	$124,811.72	$27,568.82	$13,753.34	—	—
D. W. Winkelman Co., Inc.	—	22,405.00	28,874.32	—	—
Grant M. Scruggs, Jr.	—	2,000.00	—	—	—
Johnson, Drake & Piper, Inc.	—	—	3,600.00	—	—
J. E. Greiner Company	—	—	—	$ 1,000.00	$27,500.00
Procon, Incorporated	—	—	27,000.00	12,500.00	1,000.00
C. J. Langenfelder & Son, Inc.	—	—	20,000.00	10,000.00	—
Panama-Williams Corporation	—	—	—	19,500.00	5,000.00
Brookhart & Tyo	—	—	—	—	11,500.00
Missouri Valley Dredging Company	—	—	—	—	5,000.00
Total	$124,811.72	$51,973.82	$93,227.66	$43,000.00	$50,000.00

In addition, in 1961, the petitioner received dividend income of $63.75 and had short-term capital gains of $8,989.82. In 1960, he had a short-term capital loss of $1,000.00. Such dividend income, gains, and loss were the result of transactions through a brokerage account he maintained with H. Hentz & Co., a New York City brokerage firm. In 1957, the petitioner had been discharged in bankruptcy.

Fluor Corporation

In late 1957, the petitioner contacted Richard Lyon, the international sales manager for Fluor Corporation, Ltd. (Fluor), to inquire if Fluor would be interested in building a refinery for the Iranian government. Fluor was a large international engineering and construction firm headquartered in Los Angeles, Calif. Mr. Lyon arranged a meeting between the petitioner and Mr. Ellsworth, the executive vice president of the Engineering and Construction Division of Fluor. At such meeting, the petitioner represented that he had been selected by the Iranian government to secure a responsible contractor to build a contemplated oil refinery at Qum, Iran, where oil had recently been discovered. The purpose of such meeting was to determine whether Fluor was interested in pursuing the possibility.

Subsequent meetings were held between the petitioner and senior officers of Fluor at Fluor's Los Angeles offices. Such meetings were also exploratory in nature. The petitioner assured Fluor's officers that he was at least 90 percent sure that with his support Fluor would be selected to build the Qum refinery. Fluor's officials agreed that if the petitioner could secure such project, or if the Iranian government would accept Fluor for the project, Fluor would pay the petitioner a reasonable commission. The petitioner indicated that he desired a 2½ percent commission on the entire contract price. However, no specific figure was ever agreed upon and no written agreement

was ever made. Orally, the petitioner agreed that he would bring a negotiating team from Teheran to Los Angeles, at his own expense, and that his commission, if any, would depend on the size and type of the contract obtained by Fluor.

In February 1958, the petitioner telephoned Mr. Ellsworth and requested $8,092.34 to cover the purchase price ($7,055.72) and shipping charges ($1,036.62) for two automobiles. The petitioner claimed that it was customary when a project is awarded to make such a gift to the person responsible for giving the contract. Fluor complied with such request. In February 1958, the petitioner purchased two 1958 model Chevrolets: a sport sedan and a Corvette. The purchase price for such automobiles was $7,055.72.

In February 1958, the petitioner again telephoned Mr. Ellsworth and requested $5,500, which was paid to him. Subsequently, when the petitioner claimed that he needed more funds, he telephoned Mr. Ellsworth or Mr. Lyon and requested that they send him money. Such funds were to be used by the petitioner to cover his expenses in bringing the Iranian negotiating team to Los Angeles. On a monthly basis, such payments ranged from a low of $1,000 in October 1959 to a high of $47,000 in April 1958. From February 1958 through March 1960, Fluor paid to the petitioner $105,500.

In February 1958, at the petitioner's request, Fluor furnished an air travel card to the petitioner. From April 1958 through September 1960, Fluor paid charges on such travel card of $52,433.57. Such charges ranged from a low of $350.25 in September 1958 to a high of $14,197.00 in May 1958.

On April 8, 1958, as a result of the petitioner's representations, Fluor's officers began making tentative arrangements for a party of Iranians who were to arrive in Los Angeles during the week of April 14th. On April

14, 1958, the petitioner sent Mr. Ellsworth a telegram which stated: "EVERYTHING IS ARRANGED ARRIVING NEW YORK * * * ALONE WILL CALL YOU AFSHAR." On or about April 17, 1958, the petitioner advised Mr. Lyon that the Iranian party had been delayed due to a change in the Shah's marital status. He advised Mr. Lyon that the negotiating party would arrive in Los Angeles the end of April. The party was to consist of Iran's European ambassador and head of its United Nations delegation in Europe, the Minister of Finance, the speaker of the lower house of government, two Iranian senators, and a director of the Iranian National Oil Company. The petitioner also represented to Mr. Lyon that the Shah's daughter and the ex-prime minister's son might accompany the negotiating party.

On April 25, 1958, the petitioner sent a telegram to Mr. Ellsworth that there would be a delay in the negotiating party's arrival. On May 6, 1958, Mr. Lyon received a telegram from the petitioner which stated: "I WILL CALL YOU DATE OF OUR ARRIVAL SOON. DO NOT BE CONCERNED LATE ARRIVAL EVERYTHING FINE." The petitioner continued to advise Fluor's officers that the party would be arriving shortly. The expected arrival date was changed to October, then to November, to December 1958, and on into 1959. The negotiating party never arrived in Los Angeles; nor did the petitioner ever produce any Iranian officials to discuss the proposed oil refinery contract.

In 1960, Fluor's officers informed the petitioner that they were not going to make further payments to him; the last such payment was made in March 1960. However, after Fluor terminated cash payments to the petitioner, he continued to use the air travel card. Fluor asked that such travel card be returned, but the petitioner continued to use it after such request was made. Finally, Mr. Ellsworth threatened that if the petitioner did not return the card, Fluor was going to refuse to honor

any further charges on it. Fluor refused to make further payments to the petitioner because its officers came to the conclusion that he was unable to deliver a contract or to do what he said he could do. An internal memo of Fluor dated November 1960 concluded that the petitioner was "no more than an adventurer." Also, Fluor's officers were aware that charges had been incurred on the air travel card for persons who could not have been involved with the promised contract. Except for claims by the petitioner, Fluor's officers had no knowledge that he performed any services on Fluor's behalf; nor did Fluor receive any benefits from the petitioner's services.

The petitioner never accounted to Fluor, nor was he asked to do so, for any of the funds paid to him or for charges on the air travel card. At the outset, Fluor assumed that such amounts would be deducted from the petioner's commission when it received the oil refinery contract. Fluor considered such payments and charges as advances against the petitioner's commission. No restrictions were placed upon the petitioner as to his use of the funds advanced to him. After Fluor concluded that it would not receive a contract for the oil refinery, it never requested repayment from the petitioner, since it assumed that the effort and expense would exceed what it could expect to recover. All of the payments to the petitioner were claimed as deductions by Fluor on its Federal corporate income tax returns under the heading of "Professional Services." No Forms 1099 or W-2 were issued by Fluor with respect to the payments to the petitioner.

In 1963, Fluor received a subcontract from a German firm to construct an oil refinery in Iran. However, the petitioner had nothing to do with Fluor obtaining such subcontract. In 1970, the petitioner filed suit against Fluor for commissions on such contract. Such suit was dismissed. A second suit was also dismissed.

Mr. Ellsworth was aware of the existence of an Iranian company of the petitioner's father, H. Afshar and

Company, but all of Fluor's dealings were with the petitioner. Except for a few telegrams, all dealings between Fluor and the petitioner were oral.

Grant M. Scruggs, Jr.

In 1958, Grant M. Scruggs, Jr., was the exclusive U.S. agent for the Puutalo Group of Helsinki, Finland (Puutalo). Puutalo sold prefabricated wooden housing and wooden components. In November 1958, Mr. Scruggs was introduced to the petitioner by the petitioner's attorney, Edward M. Swinburne. Mr. Swinburne informed Mr. Scruggs that the petitioner had a great deal of influence with the Shah of Iran and the people surrounding the Shah and that the petitioner could assist Mr. Scruggs in obtaining a large housing contract.

Mr. Scruggs entered into an oral agreement with the petitioner, wherein the petitioner would arrange for a delegation of Iranians to go to Helsinki for the purpose of negotiating a contract for the purchase of several thousand prefabricated houses. If a contract with the Iranians was executed, the petitioner was to be paid a commission for his services. The petitioner never indicated to Mr. Scruggs that he represented anyone other than himself as employee or agent.

In January 1959, Mr. Scruggs received a telephone call from the petitioner requesting funds to bring the Iranian delegation to Helsinki to negotiate the housing contract. Pursuant to the petitioner's request, Mr. Scruggs directed his banker to wire $2,500 to the petitioner in Switzerland. Later in January, the petitioner again telephoned Mr. Scruggs requesting an additional $1,500 to bring the Iranian delegation to Helsinki. Mr. Scruggs directed his banker to wire the additional $1,500 to the petitioner in Switzerland. The agreement between Mr. Scruggs and the petitioner was that the funds were to be used solely to pay the delegation's travel expenses from Iran to Helsinki; the petitioner was to pay his own expenses. The

petitioner never brought an Iranian delegation to Helsinki although Mr. Scruggs waited in Helsinki for them. The petitioner agreed to account to Mr. Scruggs as to the expenditure of the funds advanced to him. However, he never did so, although on several occasions, he was requested to do so by Mr. Scruggs.

Upon his return to New York City, Mr. Scruggs informed Mr. Swinburne that his $4,000 had been taken by the petitioner under false pretenses. In March 1959, after Mr. Scruggs threatened to sue the petitioner, a settlement agreement was negotiated by Mr. Swinburne. Pursuant to such agreement, the petitioner agreed to pay Mr. Scruggs' banker $2,000 in airline tickets in exchange for Mr. Scruggs' signing a general release. Mr. Scruggs agreed to such arrangement, since he felt that such arrangement was the only means of recovering anything from the petitioner. The airline tickets were purchased with the air travel card issued to the petitioner by Fluor.

D. W. Winkelman Co., Inc.

In late 1959, the petitioner entered into an oral agreement with D .W. Winkelman, president of D. W. Winkelman Co., Inc. (Winkelman Co.). Winkelman Co. was a construction contractor, specializing in highway construction. The petitioner and Mr. Winkelman agreed that the petitioner would represent a joint venture, of which the Winkelman Co. was a party, and would obtain information to aid the joint venture in the preparation of proposals to be submitted for road construction contracts in Iran. The petitioner represented himself to be an Iranian citizen who was well acquainted in Iran and could expedite the obtaining of construction contracts. The petitioner's representations were very persuasive; Mr. Winkelman was convinced that a contract would be obtained within a month or two after the date of the oral agreement.

Mr. Winkelman agreed to advance the petitioner funds to meet his expenses incurred on behalf of the joint venture. If a contract was obtained, the petitioner, if he wished, was to be employed as an interpreter and consultant and was to be given an opportunity to participate in the joint venture. The petitioner agreed that whether or not he was successful in obtaining a contract, he would personally reimburse Winkelman Co. for any funds advanced to him. At the time the agreement was entered into, it was anticipated that the petitioner's expenses would not exceed $15,000.

On November 23, 1959, Winkelman Co. issued a check to the petitioner in the amount of $5,555. Such check represented the first payment to the petitioner and was to be used by him to finance his expenses in connection with obtaining information relating to construction contracts in Iran. In anticipation of additional requests, Winkelman Co. opened a checking account in the name of the petitioner upon which he could draw with Winkelman Co.'s approval. From December 4, 1959, through April 7, 1960, the petitioner wrote 29 checks on such account, totaling $45,724.32. Except for a $200.00 check payable to American Express and a $424.32 check payable to Rogers Peet Company, all of such checks were payable either to cash, the petitioner, or the Societe de Banque Suisse. Winkelman Co. treated the funds advanced to the petitioner as prepaid engineering expenses, since it was believed that such funds would be charged against a specific contract. Winkelman Co. did not issue Forms 1099 or W-2 with respect to the payments to the petitioner.

From December 1959 through April 1960, the petitioner gave Mr. Winkelman various reasons for his inability to produce any results. However, he consistently reassured Mr. Winkelman that his acquisition of the desired information was imminent. In April 1960, Mr. Winkelman refused to advance any further funds to the

petitioner. The reason for such action was that the petitioner had not produced any tangible or recognizable accomplishments on behalf of Winkelman Co. After their initial meeting, the only communications between the petitioner and Mr. Winkelman consisted of telephone calls when the petitioner claimed to need more funds.

The petitioner has never accounted to Winkelman Co. as to the use of the funds advanced to him. The petitioner has never repaid any of such funds, despite his oral agreement to do so and despite repeated requests by Winkelman Co. for repayment. However, the petitioner continued to reassure Mr. Winkelman that such monies would be repaid, even after Winkelman Co. cut off all funds to the petitioner. Winkelman Co. employed attorneys in an effort to collect the funds advanced to the petitioner, but no legal proceedings were ever instituted to enforce collection of such funds. Winkelman Co. never did any work in Iran, nor were discussions ever had with Iranian officials. Except for claims by the petitioner, Mr. Winkelman has no knowledge that the petitioner performed any services on behalf of Winkelman Co.; nor did Winkelman Co. receive any benefit from the petitioner's services. The petitioner did not represent to Mr. Winkelman that he was a representative or employee of H. Afshar and Company.

Johnson, Drake & Piper, Inc.

On several occasions during the first half of 1960, the petitioner contacted Robert P. Bayard, who was the foreign manager and executive vice president of Johnson, Drake & Piper, Inc., General Contractors (JDP). The petitioner represented to Mr. Bayard that he might be of great assistance in selling a "package" job to the Iranian government for engineering and construction of a proposed highway in Iran. JDP's share of such package job was to be 90 percent and would cover construction services. The petitioner stated that it would be necessary for

him to travel to Iran to pursue the matter further and that he could, and would, pay his own travel expenses. The petitioner estimated that the total cost for such trip, including his time in Iran, would be $4,000.

In June 1960, shortly before he was to have left for Iran to pursue the package job, the petitioner advised Mr. Bayard that he had been unable to collect certain funds due him for services rendered. Mr. Bayard agreed to advance the petitioner 90 percent of his estimated travel expenses, $3,600. The other 10 percent of such travel expenses was to be paid by Erdman, Smock, Hosley & Reed, Inc., the engineering firm which was to receive the other 10 percent of the package job. On June 13, 1960, JDP issued a check to the petitioner in the amount of $3,600. It was orally agreed that if a contract were obtained, such amount was to be deducted from the petitioner's commission, although no agreement had been reached as to a specific commission arrangement. If a contract was not obtained, the petitioner was not required to repay the $3,600. No restrictions were placed on the petitioner's use of such $3,600.

After the check was delivered to the petitioner, Mr. Bayard never heard from the petitioner again. Mr. Bayard has no knowledge of what expenses the petitioner incurred or what use was made of the $3,600. Also, Mr. Bayard has no knowledge of what services, if any, the petitioner performed for JDP. JDP never requested repayment of such funds, nor has legal action been taken to collect such funds from the petitioner. JDP did not issue a Form 1099 or a Form W-2 with respect to the payment to the petitioner. On its Federal income tax return, JDP deducted such payment as a foreign promotion expense.

J. E. Greiner Company

In the middle of 1960, the petitioner was introduced to Edward J. Donnelly, who was a partner of J. E.

Greiner Company (Greiner Co.), a consulting engineering firm in Baltimore, Md. The petitioner represented that he was "well connected" in Iran and that he could obtain for Griener Co. a general management agreement with the Iranian government. Preliminary meetings were held, and thereafter, the petitioner informed Mr. Donnelly that Greiner Co. was acceptable to the Iranian government.

In the fall of 1961, the petitioner entered into an oral agreement with Greiner Co., wherein the petitioner agreed to represent Greiner Co. in securing from the Iranian government a contract to act as general advisor for Iran's 7-year plan. The petitioner was to be paid a fee of $500 per week for his services and expenses. Pursuant to such agreement, Greiner Co. paid the petitioner $1,000 in 1961 and $17,500 in 1962. From August 13, 1962, through December 31, 1962, his weekly compensation checks, at his request, were drawn payable to his wife, Yvonne Afshar. During 1962, checks payable either to the petitioner or to his wife totaling $5,250 were endorsed by the petitioner's attorney Edward M. Swinburne. In addition to his weekly compensation, Greiner Co. made a $10,000 payment to the petitioner in 1962. Such payment was made at his request and was cabled to him in Geneva, Switzerland.

The petitioner was not required to account to Greiner Co. as to how the funds paid to him were spent, and he has never done so. No restrictions were placed on the petitioner's use of the funds paid to him. The petitioner was under no obligation to repay the funds paid to him, and he has not repaid them.

Greiner Co., with the petitioner's assistance, prepared a proposed agreement for submission to the Iranian government. On September 13, 1962, Greiner Co. mailed such agreement to the petitioner in Geneva, Switzerland. However, such agreement was never acted upon. Greiner Co. never discussed any other projects with the petitioner,

nor did it receive any project layouts from the Iranian government. Except for claims by the petitioner, Mr. Donnelly has no knowledge that the petitioner rendered any services or expended any funds on behalf of Greiner Co. In his dealings with Greiner Co., the petitioner represented himself to be an American citizen who operated as an individual.

The Greiner Co. issued Forms 1099 to the petitioner showing compensation of $1,000 received during 1961 and $27,500 during 1962. Such forms were mailed to the petitioner at his residence in Glen Ridge, N.J.

Procon, Incorporated

In October 1960, the petitioner met with the president, C. B. Whyte, and the vice president, C. B. Robbins, of Procon, Incorporated (Procon), which was located near Chicago, Ill. Procon was a construction company specializing in petroleum refineries and chemical plants. Such meeting was arranged by Mr. Donnelly of Greiner Co., who had recommended Procon to the petitioner. The petitioner had commissioned Mr. Donnelly to locate a qualified engineering and construction company to build a contemplated refinery near Teheran, Iran. The petitioner told Messrs. Whyte and Robbins that Greiner Co. had been selected by the Iranian government as consulting engineers on several large projects, including the construction of the refinery. The petitioner represented that he had submitted Procon's name to the Iranian government for approval, and that he had been authorized to negotiate with Procon on Iran's behalf. However, the terms of the actual contract would be negotiated between Procon and other representatives of the Iranian government.

In the discussions with Procon, the petitioner did not represent himself to be an official of the Iranian government, but he claimed to be a close personal friend of the Shah and his personal representative in the selection of

contractors. The petitioner stated that the Shah had asked him to find qualified contractors because of the unsatisfactory experience the Iranians had had with certain contractors. The petitioner advised Procon's officers that he would attempt to aid them in securing an oil refinery construction contract.

Later in October, another meeting was held with Procon, at which the petitioner again advised Messrs. Whyte and Robbins that Greiner Co. was the consulting engineer on the refinery project. However, the petitioner emphasized that he was to be Procon's only contact and that they were to have no direct contact with Greiner Co.

On November 16, 1960, Procon entered into a letter agreement with the petitioner, which provided that Procon would prepare a preliminary economic feasibility report to be presented to the appropriate Iranian officials by the petitioner. After he presented the report, the petitioner was to use his best efforts to bring the appropriate Iranian officials to Procon's offices to view its facilities and to discuss further the feasibility report. To accomplish such objectives, Procon agreed to advance $20,000 to the petitioner. Such funds were to be used for the necessary travel and living expenses of the petitioner and the Iranian officials who were to vist Procon's offices. The petitioner agreed to document his expenditures with appropriate travel and expense vouchers, which were to be forwarded to Procon. If a contract were obtained, the funds advanced were to have been included in the overall base bid or otherwise were to be reimbursed to Procon. If a contract was not obtained, the petitioner was not obligated to repay the funds advanced.

The initial $20,000 was deposited to the petitioner's account at the Riggs National Bank, Washington, D.C. From December 1960 through September 1962, the petitioner requested and received the following additional advances from Procon:

Date	Amount	Form of Remittance
12/ 7/60	$7,000	Wire transfer to Geneva, Switzerland
1/26/61	6,000	Check
3/28/61	3,000	Wire transfer to Geneva, Switzerland
10/10/61	3,500	Check
9/13/62	1,000	Check

On October 10, 1961, the petitioner executed a letter agreement supplementing the letter agreement of November 16, 1960. In the supplemental agreement, the petitioner acknowledged receipt of the funds advanced to that date, $39,500, and agreed to forward to Procon appropriate documentation as to his expenditure of such funds. The supplemental agreement reiterated that the funds advanced to the petitioner were for the petitioner's necessary travel and promotional expenses in connection with the refinery project.

The petitioner has never submitted vouchers to Procon or otherwise substantiated his expenditures, although he has been requested to do so on several occasions. The petitioner has not repaid the funds advanced to him, although he has never been asked to do so, and Procon has never taken any legal action to recover such funds. The petitioner did not produce a contract for Procon. Except for the claims by the petitioner, Mr. Robbins has no knowledge that the petitioner performed any services on behalf of Procon. In 1977, the petitioner sued Procon claiming damages for breach of an agency agreement, but such suit was dismissed as untimely.[2]

On advice of its tax counsel, Procon did not issue a Form 1099 to the petitioner for 1960. However, Forms 1099 were issued to the petitioner for 1961 and 1962, showing compensation of $12,500 in 1961 and $1,000 in 1962. On its Federal income tax returns, Procon claimed deductions for the amounts paid to the petitioner either

[2] *Afshar v. Procon, Inc.*, 442 F.Supp. 887 (S.D.N.Y. 1977).

as a prepaid sales expense or as a sales promotion expense. At that time, Procon used the completed contract method of accounting. During the years in issue, Mr. Robbins was not aware of whether the petitioner had a business address in Iran.

C. J. Langenfelder & Son, Inc.

In late 1960, the petitioner entered into an oral agreement with C. J. Langenfelder & Son, Inc. (Langenfelder & Son), which was a contractor in Baltimore, Md., specializing in highway construction. The terms of such agreement provided that the petitioner would present Langenfelder & Son's qualifications to the Iranian government for consideration in performing heavy construction work within Iran. The petitioner represented to Langenfelder & Son's officers that he could obtain for them heavy construction projects on a cost-plus basis. However, no specific project was ever discussed. At the petitioner's request, Langenfelder & Son prepared an elaborate brochure describing the company's history and accomplishments. The petitioner was to present such brochure to the Iranian government. The petitioner represented that his main interest was in Iran's welfare and that, by securing for Iran a competent, financially independent heavy contractor, he would help Iran to build ultilities and provide employment.

The petitioner requested an advance of $10,000, which was to be repayable upon demand whether or not a contract was obtained. On November 21, 1960, Langefelder & Son issued a check to the petitioner in the amount of $10,000. On December 7, 1960, Langenfelder & Son advanced an additional $10,000 to the petitioner, which was wired to him in Geneva, Switzerland. A third advance of $10,000 was paid to the petitioner on February 3, 1961. The timing and amounts of such advances were the result of the petitioner's requests, which were made orally, either in person or via telephone. Langenfelder & Son treated such payments as advances, not as compensa-

tion, which were expected to be repaid. The petitioner assured Langenfelder & Son's officers that they could request payment at any time. No restrictions were placed on the petitioner's use of such advances, nor was he required to account for their expenditure.

The petitioner has never repaid the $30,000 advanced to him by Langenfelder & Son, nor has he ever accounted to Langenfelder & Son as to his expenditure of such $30,000. In 1964, Langenfelder & Son wrote off such advances as bad debts in its books and records. During the years in issue, Charles H. Scheeler was general manager of Langenfelder & Son's accounting department, and at the time of trial, he was president of such company. Mr. Scheeler has no knowledge of the services rendered by the petitioner on Langenfelder & Son's behalf or any benefits received through the petitioner's efforts. Nor does he have any knowledge whether the petitioner was ever requested to repay or account for the funds advanced to him. During the years in issue, the only address for the petitioner known by Mr. Scheeler was in New Jersey. No Forms 1099 or W-2 were issued to the petitioner by Langenfelder & Son.

Brookhart & Tyo

In 1962, Mr. Donnelly of Greiner Co. introduced the petitioner to G. Clinton Brookhart, partner of the firm of Brookhart & Tyo, Consulting Engineers (Brookhart & Tyo). The petitioner represented that he was in a position to become Administrator of Public Works in Iran and that he was attempting to negotiate a contract to make Greiner Co. overall consultants on public works projects in Iran. The petitioner represented that Brookhart & Tyo would be granted some of such public works projects. The petitioner and Mr. Brookhart discussed the preliminary layouts on a "dock project."

No written agreement was reached with the petitioner, but orally, Brookhart & Tyo agreed to advance funds to

the petitioner for his travel expenses incurred in connection with the public works contracts. Brookhart & Tyo made the following advances to the petitioner:

Date	Amount
4/30/62	$ 4,000
7/30/62	2,500
11/15/62	5,000
	$11,500

The requests for such advances were made by the petitioner via telephone. The petitioner has never accounted to Brookhart & Tyo as to how such funds were expended, but an accounting was never requested. As of January 1964, the petitioner had not negotiated the public works contract. Mr. Brookhart understood that the delay was due to internal conditions in Iran. Brookhart & Tyo did not issue a Form 1099 or a Form W-2 to the petitioner. On its Federal partnership return, Brookhart & Tyo claimed a deduction for such payments as business expenses. Both Mr. Brookhart and Raymond J. Tyo are now deceased.

Panama-Williams Corporation/
Missouri Valley Dredging Company

In late 1961, the petitioner met with M. S. Williams, president of Panama-Williams Corporation (Panama-Williams), and Joe G. McMaken, president of Missouri Valley Dredging Company (Missouri Valley). Both Panama-Williams and Missouri Valley were engaged in pipeline construction. At such meeting, the petitioner represented that he had certain connections in Iran that would be necessary if Panama-Williams or Missouri Valley was to obtain a pipeline construction contract in Iran. Mr. Williams believed that some "payoffs" would be required in order to obtain such a contract and that the petitioner was probably the person in the United States who handled such matters.

The petitioner assisted Mr. Williams and Mr. McMaken in preparing a letter to the Shah offering the services of their companies in the construction of oil pipelines. In addition, petitioner advised Messrs. Williams and McMaken that to obtain a construction contract it would be necessary for him to bring a team of technical personnel from Iran to the United States to evaluate their proposal. The cost of such trip was to be paid by Messrs. Williams and McMaken. It was mutually agreed that $12,000 would be needed for such purpose.

On December 5, 1961, Mr. Williams issued a check to the petitioner in the amount of $12,000. The petitioner converted such check into traveler's checks. At such time, Messrs. Williams and McMaken did not enter into a contract with the petitioner. However, it was understood that if a contract was obtained, the petitioner was to share in the profits from such a contract.

Approximately 2 weeks later, the petitioner telephoned Mr. Williams from Geneva, Switzerland. He advised Mr. Williams that it would be necessary to bring more personnel to the United States than he had originally anticipated. The petitioner estimated that the inclusion of the additional personnel would entail an additional expenditure of $7,500 and requested that Mr. Williams cable such amount to him in Geneva. On December 19, 1961, Mr. Williams complied with the petitioner's request.

In February 1962, the petitioner again telephoned Mr. Williams from Geneva. He advised Mr. Willams that it was unlikely that the original deal would go through, but that there were other deals that might be worked out. The petitioner told Mr. Williams that he had already spent the $19,500 advanced to him and that he needed an additional $5,000 to work on a new deal. At such time, the petitioner promised to repay the funds advanced to him.

Mr. Williams was reluctant to advance any additional funds to the petitioner. However, the petitioner indicated

that he needed the additional $5,000 immediately. In an effort to salvage something from the money already advanced, Mr. Williams cabled to the petitioner the $5,000 requested by him. Subsequently, Mr. Williams learned that the petitioner had already obtained $5,000 from Mr. McMaken.

In May 1963, the petitioner telephoned Mr. Williams and told him that funds which had been "tied-up" in Switzerland had recently become available, that he was going to mail a check to Mr. Williams for part of the money he owed to Messrs. Williams and McMaken, and that he would pay the balance of the money owed in June. Mr. Williams never heard from the petitioner again.

The petitioner never repaid the funds advanced to him, nor has he ever accounted for his expenditure of such funds. The petitioner never produced any technical personnel to discuss any projects with Mr. Williams or Mr. McMaken. Panama-Williams never received a contract to do work in Iran. Mr. Williams has no personal knowledge of whether the petitioner traveled to Iran on his behalf, nor is he aware of whether the petitioner had a business address other than his home in New Jersey. Panama-Williams did not issue a Form 1099 or a Form W-2 to the petitioner.

Business Expense Deductions

During the years in issue, the petitioner traveled extensively in the United States and Europe. He traveled to Iran once each year during the month of March. He incurred substantial expenses in connection with such travel. Also, during such period, he incurred substantial telephone expenses. In his notice of deficiency, the Commissioner allowed the petitioner the following deductions for business expenses:

	1958	1959	1960	1961	1962
Hotels	$ 163.47	$ —0—	$ 1,047.31	$2,217.58	$ 598.01
Telephone	647.48	550.12	1,448.37	1,528.12	1,430.97
Air Travel	11,289.06	12,907.11	9,736.56	316.00	—0—
Total	$12,100.01	$13,457.23	$12,232.24	$4,061.70	$2,028.98

IRS Investigation of the Petitioner

In early 1961, the IRS commenced its investigation of the petitioner. In connection with such investigation, search requests were directed to several District offices to determine if there was a record of returns having been filed by the petitioner. Such searches were made under the petitioner's and his wife's first names, last name, and middle names, as well as various spellings of such names, and several possible addresses. The dates of such searches, the District offices to which they were directed, and the years searched were as follows:

District Office Searched	Date of Search Request	Years Searched
Newark, N.J.	4/18/63	1947-1961
	4/ 6/64	1962
International Operations	11/ 1/63	1962
	4/ 2/64	1957-1961
Manhattan, N.Y.	4/17/63	1947-1961
	7/18/63	1947-1961
	11/ 1/63	1962
Brooklyn, N.Y.	4/17/63	1947-1961
	11/ 1/63	1962
Baltimore, Md.	5/24/63	1957-1961
	11/ 1/63	1962
Augusta, Maine	4/19/63	1947-1961
	11/ 1/63	1962

Such searches revealed no record of Federal income tax returns having been filed by the petitioner or the payment of estimated taxes by him in any of the years searched. If the petitioner had filed any return using his Glen Ridge, N.J., address, such a return should have been filed with the Newark District Office. If the petitioner had filed any return using an Iranian address, such a return should have been filed with the Office of International Operations.

In 1978 and 1979, the IRS again undertook to determine if there was a record of returns having been filed

by the petitioner. The service centers to which such search requests were directed were as follows:

Service Center	Years Searched
Brookhaven, N.Y.	1953-1970
Philadelphia, Pa.	1952-1970
Andover, Mass.	1958-1970

The search at the Philadelphia Service Center disclosed a return that had been filed by the petitioner for 1968 with the Office of International Operations. It also revealed that something had been filed by the petitioner in 1952; however, because of the age of the record, it was not possible to determine the nature of such filing. Such searches disclosed no record of returns having been filed by the petitioner for the years 1958 through 1962. If the petitioner had filed any return using his Glen Ridge, N.J., address, the record of such return would have been located in the Brookhaven Service Center. If the petitioner had filed any return using an Iranian address, the record of such return would have been located in the Philadelphia Service Center.

In 1963, the petitioner and his attorney, Mr. Swinburne, filed with the IRS applications for extension of time to file the petitioner's 1962 return. The reason given by the petitioner for such extension was that he had not received documentation of his expenses from overseas and that therefore an accurate return could not be prepared. On the application for extension dated September 18, 1963, which was signed by the petitioner, he stated that returns had been filed from overseas for two of the three prior years (1959, 1960, and 1961). The reason given for not filing a return for one of such years was that the petitioner had no income during such year. As of 1965, Mr. Swinburne admitted that the petitioner had not filed completed returns for 1961 and 1962.

In 1965, a criminal information was filed against the petitioner in the U.S. District Court in Newark, N.J.

Such information alleged a willful failure to file Federal income tax returns for the years 1958 through 1962. In 1969, the Government dropped the other counts of such information, and the petitioner pled nolo contendere to such charge for 1958 and was fined $2,000 and was placed on probation for 1 year.

In June 1961, the petitioner and Mr. Swinburne met with the special agent in charge of the investigation of the petitioner. At such meeting, the petitioner stated that he had filed Federal income tax returns from overseas for the years 1957 through 1959. The petitioner promised to obtain copies of such returns from Iran and make copies available for inspection. At such meeting, the petioner admitted receiving $3,600 from JDP but claimed that such funds were in the nature of an advance and were not income to him.

Allegedly due to the petitioner's frequent travels, the next meeting between the petitioner and the special agent was not held until January 4, 1962. At such time, the petitioner made available checks issued by his wife during 1958. The petitioner stated that he had filed returns with the Office of International Operations for the years 1957 through 1960, that copies of such returns were in Iran, and that he would obtain copies of such returns whenever possible. The petitioner further stated that he had no income during such years and that all funds received by him during such period were either loans from relatives or advances for expenses. On January 17, 1962, Mr. Swinburne advised the special agent that the petiiioner's tax records were in Mrs. Swinburne's office and that he would advise the special agent when the records were available for his examination.

On April 19, 1962, another meeting was held with the special agent. At such meeting, the special agent again requested that the petitioner make available information as to his income and expenses and copies of his returns,

and indicated that if such information was not made available, third-party inquiries would be necessary. The petitioner brought to such meeting a suitcase which he claimed contained documentary proof of his expenditures for airline tickets and hotels. However, the special agent was not allowed to examine the contents of such suitcase.

On August 15, 1962, the special agent telephoned Mr. Swinburne and inquired when the information requested at the April 19th meeting would be made available. Mr. Swinburne stated that his accountant was analyzing data furnished by the petitioner and that Mr. Swinburne would submit the results of such analysis, if satisfactory, after the accountant completed his work. The special agent stated that if such information was not furnished promptly, he would have to resort to third-party inquiries. As of April 17, 1963, Mr. Swinburne reported to the special agent that he had not received either the accountant's report or copies of the petitioner's returns. During 1961 through 1964, neither the petitioner nor Mr. Swinburne furnished any further information to the IRS with respect to the petitioner's income and deductions; nor were copies of the petitioner's returns ever produced. As a result, the IRS resorted to the specific item method of reconstructing the petitioner's income and allowed him deductions based on information received from third parties.

Based on his investigation, the Commissioner concluded that for each of the years in issue the petitioner had received unreported income in excess of his allowable deductions. Accordingly, in his notice of deficiency, the Commissioner determined that there was an underpayment of tax for each of the years in issue. In addition, the Commissioner determined that all or a part of the underpayment for each year was due to fraud and that the petitioner had underpaid his estimated tax for each of the years in issue.

Opinion

The issues for decision are: (1) Whether the petitioner underpaid his Federal income taxes for any of the years in issue; (2) whether any underpayment of tax was due to fraud within the meaning of section 6653(b); and (3) whether the petitioner is liable for additions to tax under section 6654 for underpayment of estimated taxes. We will consider first the issue of whether there were deficiencies in tax.

Issue 1. Deficiencies in Tax

The petitioner has stipulated that he received gross income of $124,811.72 in 1958, $51,973.82 in 1959, $93,227.66 in 1960, $43,000 in 1961, and $50,000.00 in 1962. In arriving at the petitioner's taxable income for each of such years, the Commissioner, in his notice of deficiency, allowed the petitioner certain deductions for business expenses. The petitioner claims that he incurred deductible business expenses in excess of the amounts allowed by the Commissioner, and that, as a result, he owes no tax for each of the years in issue.[3] The expenses claimed by the petitioner are as follows:

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[3] Although the deductions claimed by the petitioner for 1958 and 1959 are less than his gross income for such years, he contends that there would be no tax liability for such years due to a carryback of his net operating losses from 1960, 1961, and 1962. See sec. 172.

Expenses claimed by Petitioner	1958	1959	1960	1961	1962
Air travel	$21,914.66	$17,603.88	$ 15,770.73	$ 5,655.44	$ 7,016.42
Telephone	647.48	550.12	1,448.37	1,528.12	1,430.97
Hotels	10,459.26	1,198.28	7,276.77	12,494.53	9,135.07
Registration expenses and fees	36,500.00	—	72,000.00	96,300.00	83,800.00
Travel and entertainment	—	989.77	7,257.05	880.11	—
Total	$69,521.40	$20,342.05	$103,752.92	$116,858.20	$101,382.46
Expenses allowed by Commissioner	12,100.01	13,457.23	12,232.24	4,061.70	2,028.98
Additional expenses claimed	$57,421.39	$ 6,884.82	$ 91,520.68	$112,796.50	$ 99,353.48

The decision as to whether there were deficiencies depends on whether the petitioner was entitled to the additional deductions claimed by him; he has the burden of proving that he is entitled to such deductions. Rule 142 (a), Tax Court Rules of Practice and Procedure; *Welch v. Helvering* [3 USTC ¶ 1164], 290 U.S. 111 (1933).

Section 162(a) provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Neither party has argued that the petitioner was not carrying out a trade or business during the years in issue; the Commissioner contends that the petitioner was in the trade or business of swindling, while the petitioner contends that he was in the trade or business of representing various companies in their efforts to obtain work in Iran. In either case, the petitioner is entitled to deduct the expenses which he can prove that he incurred in carrying on his trade or business. See *Commissioner v. Sullivan* [58-1 USTC ¶ 9368], 356 U.S. 27 (1958).

The deductions allowed by the Commissioner for air travel, hotels, telephone, and entertainment expenses were based on records received from third parties, principally charges incurred on the Fluor air travel card, and on a box of receipts and cancelled checks provided by the petitioner. In deciding the expenses to be allowed, the agents included most items which showed travel by the petitioner. They excluded travel expenses where the receipts showed travel by the petitioner's relatives or Mr. Swinburne, or where the persons' names were unknown to the agents, or where they did not believe the destinations were business related. The included expenses were allowed without substantiation as to whether such expenses were actually incurred for business rather than personal reasons.

The petitioner contends that all the expenses claimed by him are deductible business expenses with the exception of expenses attributable to three trips his wife made with him to Nassau, Bahamas, Paris, France, and Washington,

D.C. Moreover, he contends that the amount he claims for entertainment expenses represents less than 10 percent of his actual expenses, since the majority of his entertainment was done overseas and since it was his custom to leave all accumulated bills and receipts in Iran and bring back to the United States only his return trip bills and receipts. However, the petitioner is unable to set forth the names of the persons he claims to have entertained, the nature of the conversations, or otherwise state the business reason for incurring such expenses.

The years in issue were prior to the effective date of section 274, which was made applicable to taxable years ending after December 31, 1962. Rev. Act of 1962, Pub. L. 87-834, sec. 4, 76 Stat. 974, 977. Thus, the petitioner need not meet the stringent substantiation requirements of such section, and he asks us to invoke the rule of *Cohan v. Commissioner* [2 USTC ¶ 489], 39 F.2d 540 (2d Cir. 1930). However, he has failed to satisfy the conditions for the application of that rule.

The *Cohan* rule, when applicable, permits a deduction based on estimates where the Court is convinced, from the record, that deductible expenses have in fact been incurred. As stated in *Williams v. United States* [57-2 USTC ¶ 9759], 245 F.2d 559, 560 (5th Cir. 1957), *Cohan* requires that "there be sufficient evidence to satisfy the trier that *at least* the amount allowed in the estimate was in fact spent or incurred for the stated purpose. Until the trier has that assurance from the record, relief to the taxpayer would be unguided largesse." (Emphasis in original.)

It is clear from the record that the petitioner must have incurred some deductible expenses during the years in issue. However, it is equally clear that we have little guidance as to what portion of the petitioner's expenditures for travel, hotels, and telephone were incurred for business rather than personal reasons. The deductions allowed by the Commissioner were based on a presumed

business nexus for the allowed expenditures. The Commissioner was highly generous in the deductions he allowed, and generally, the evidence fails to convince us that any additional deductions were allowable. The receipts offered into evidence by the petitioner fail to show a business reason for the petitioner's expenditures. The only corroboration offered by the petitioner was his own self-serving testimony, which we are not required to, and do not, accept. See *Armes v. Commissioner* [71-2 USTC ¶ 9539], 448 F.2d 972 (5th Cir. 1971), *affg.* on this issue a Memorandum Opinion of this Court.

With respect to 1961 and 1962, however, we are convinced that for business purposes the petitioner did incur air travel expenses in excess of the amounts allowed by the Commisioner. We find and hold that the following air travel expenses are deductible:

Date	Destination	Amount
1/ 9/61	New York to Chicago to Baltimore	$116.93
2/ 2/61	Newark, N.J. to Baltimore	16.23
3/ 6/61	Baltimore to New York	16.23
6/18/61	New York to Baltimore	16.23
10/10/61	New York to Chicago to New York	116.93
11/15/61	New York to Chicago to Baltimore	86.85
12/ 5/61	Houston to Chicago to Baltimore	209.72
6/22/62	Portland, Maine, to Boston to Chicago to Newark, N.J.	114.84
7/30/62	Newark, N.J. to Baltimore to New York	38.06

The Commissioner allowed the petitioner deductions for air travel of $316.00 for 1961 and none for 1962; according to our holding, the petitioner is entitled to the additional amounts of $263.12 for 1961 and $152.90 for 1962. Our reason for allowing the petitioner a deduction for such additional expenses is that the dates and destinations of such travel correspond with the locations and time period of the petitioner's receipt of income from Procon,

Greiner Co., Missouri Valley, and Panama-Williams. In summary, with the exception of the additional air travel expenses for 1961 and 1962, we find and hold that the petitioner has failed to prove that he incurred deductible air travel, hotel, telephone, and entertainment expenses in excess of the amounts allowed by the Commissioner.

The petitioner also contends that he is entitled to a deduction for registration fees and legal expenses which he claims to have incurred on behalf of the companies from which he received gross income. The fees which the petitioner claims to have incurred are as follows:

	Fluor	Procon	Panama-Williams	Missouri Valley
Iranian registration to do business in Iran	$ 5,000	$ 5,000	$ 5,000	$ 5,000
National Iranian Oil Company				
Legal fee	15,000	10,000	5,000	2,000
Registration fee	—	—	—	—
Iranian Gas Company				
Legal fee	15,000	10,000	5,000	4,000
Registration fee	—	—	—	—
Department of Labor				
Legal fee	3,000	3,000	2,000	3,000
Registration fee	1,500	3,000	2,000	3,000
Department of Plan Organization				
Legal fee	—	—	—	5,000
Registration fee	—	—	—	4,000
	$36,500 (Spent in 1958)	$31,000 (Spent half in 1960 and half in 1961)	$19,000 (Spent in 1961)	$26,000 (Spent in 1962)

	Winkelman Co.	Greiner Co.	Langenfelder & Son	Brookhart & Tyo
Iranian registration to do business in Iran	$ 5,000	$ 5,000	$ 5,000	$ 5,000
Department of Plan Organization				
Legal fee	5,000	5,000	5,000	5,000
Registration fee	10,000	10,000	7,000	4,000
Purchase of project layout (5 to 10)	—	30,000	—	—
Ministry of Roads				
Legal fee	5,000	5,000	5,000	5,000
Registration fee	5,000	3,000	3,000	3,000
Purchase of project layouts (2 to 4)	—	8,000	—	—
Department of Labor				
Legal fee	3,000	—	—	3,000
Registration fee	3,000	—	—	1,000
Port Authority				
Legal fee	5,000	5,000	5,000	—
Registration fee	3,000	5,000	4,000	—
Ministry of Housing & Development				
Legal fee	—	5,000	—	—
Registration fee	—	5,000	—	—
Department of Railroads				
Legal fee	—	5,000	2,000	—
Registration fee	—	1,000	1,500	—
	$44,000 (Spent in 1960)	$92,000 (Est. 40% spent in 1961, 40% spent in 1962)	$37,500 (Est. ⅓ spent in 1960 and the rest in 1961)	$26,000 (Spent in 1962)

The only evidence the petitioner introduced in support of his right to such deductions was his own self-serving testimony. He claims that his lack of documentary evidence is due to the seizure of his business records by the

Iranian secret police (SAVAK) in 1967, and that such records were turned over to the American Embassy in Teheran, Iran. He further maintains that officials of the American Embassy either destroyed such records or that officials of the U.S. Government have wrongfully withheld such records despite the petitioner's efforts to obtain such records by an action under the Freedom of Information Act. Thus, the petitioner asks us to accept his testimony and, pursuant to Rule 201,[4] Federal Rules of Evidence, and Rule 146,[5] Tax Court Rules of Practice and Procedure, to take judicial notice of the existence of the necessity of paying such fees and expenses.

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[4] Rule 201, Federal Rules of Evidence, provides in relevant part:

(a) Scope of rule.—This rule governs only judicial notice of adjudicative facts.

(b) Kinds of facts.—A judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.

(c) When discretionary.—A court may take judicial notice, whether requested or not.

(d) When mandatory.—A court shall take judicial notice if requested by a party and supplied with the necessary information.

* * *

(f) Time of taking notice.—Judicial notice may be taken at any stage of the proceeding.

Rule 143(a), Tax Court Rules of Practice and Procedure, provides that the rules of evidence applicable in the U.S. District Court for the District of Columbia shall apply to trials before the Tax Court. See also sec. 7453. Thus, Rule 201, Federal Rules of Evidence, is applicable to the Tax Court.

[5] The petitioner asks that we apply Rule 44.1, Federal Rules of Civil Procedure. The Tax Court Rules of Practice and Procedure, not the Federal Rules of Civil Procedure, are applicable to trials before this Court. Thus, we have assumed that the petitioner seeks for us to apply Rule 146, Tax Court Rules of Practice and Procedure, the equivalent of Rule 44.1, Federal Rules of Civil Procedure.

Rule 201(d), Federal Rules of Evidence, mandates that the party who requests a court to take judicial notice of an adjudicative fact supply such court with the necessary information to do so. The information which the petitioner has furnished us is an excerpt from an official publication of the U.S. Department of Commerce, Industry and Trade Administration, entitled "An Introduction to Contract Procedures in the Near East & North Africa." Such publication is undated and was apparently issued sometime after October 8, 1977. Thus, we do not know if information contained therein is applicable to the years in issue. What is more, although such publication does state the requirement that a company seeking to obtain a contract in Iran register with the Plan and Budget Organization of Iran, it gives no information as to what fees, if any, are involved in such registration. Hence, even if the requirement of the payment of registration fees and legal expenses were an adjudicative fact within the meaning of Rule 201(b), Federal Rules of Evidence, the petitioner has failed to supply us with the necessary information for Rule 201 to apply to this case.

Likewise, the petitioner has failed to bring himself within the applicability of Rule 146, Tax Court Rules of Practice and Procedure. Rule 146 is taken almost verbatim from Rule 44.1, Federal Rules of Civil Procedure. See Note to Rule 146, 60 T.C. 1057, 1137 (1973). Such rule requires that a party who intends to raise an issue concerning the law of a foreign country "shall give notice in his pleadings or other reasonable written notice." However, the petitioner failed to give such notice. See *Com'l Ins. Co. of Newark v. Pacific-Peru Const.*, 558 F.2d 948 952 (9th Cir. 1977); *Ruff v. St. Paul Mercury Insurance Co.* [60-1 USTC ¶ 9289], 393 F.2d 500, 502 (2d Cir. 1968); A. Miller, "Federal Rule 44.1 and the 'Fact' Approach to Determining Foreign Law: Death Knell for a Die-Hard Doctrine," 65 Mich. L. Rev. 615, 645-649 (1967). More-

over, we are not limited in our consideration of foreign law to the materials submitted by the parties; but where neither party has offered any material with respect to the applicable foreign law, we need not take judicial notice of such law. See *Bowman v. Grolsche Bierbrouwerij B. V.*, 474 F. Supp. 725, 730 (D. Conn. 1979); *Corporation Venezolana de Fomento v. Vintero Sales*, 452 F. Supp. 1108, 1112 (S.D.N.Y. 1978); *Petition of Petrol Shipping Corp.*, 37 F.R.D. 437, 440 (S.D.N.Y. 1965), affd. 360 F.2d 103 (2d Cir. 1966), cert. denied 385 U.S. 931 (1966); compare *Reese v. Commissioner* [Dec. 33,257], 64 T. C. 395 (1975).

Even if we were to treat the necessity of paying registration fees and expenses as an adjudicative fact and even if we were to take judicial notice that Iranian law required the payment of such expenses, the petitioner has utterly failed to meet his burden of proving that he paid such expenses. The petitioner testified that such expenses were paid through his father's company, H. Afshar and Company, and that each of the American companies was routinely notified of the incurrence of such expenses. However, not one of the executives of such companies was able to recall having received such notification; nor did any of them have any knowledge that the petitioner performed any services on their behalf. Thus, to accept the petitioner's testimony, it would be necessary to reject the testimony of all the Commissioner's witnesses, persons who had no reason to falsify their testimony.

We also find the petitioner's testimony concerning the alleged seizure of his business records to be an unsatisfactory explanation of his failure to produce such records. The alleged seizure did not take place until 1967. Yet, from 1961 through 1967, the petitioner repeatedly was requested by the IRS to bring forth his books and records. During such period, his story was always the same—that his books and records were in Iran and that they would be forthcoming. However, during such period when, ac-

cording to his testimony, he would have had free access to such books and records, he never produced them. In the light of these circumstances, we are simply not convinced that the alleged books and records ever existed, and accordingly, we hold that the petitioner has failed to carry his burden of proving that he is entitled to any of the deductions for registration fees and legal expenses.

Issue 2. Fraud

The next issue for consideration is whether any part of the underpayment of taxes for each of the years in issue was due to fraud with intent to evade tax within the meaning of section 6653(b), which provides in part:

> (b) Fraud.—If any part of any underpayment * * * of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. * * *

The Commissioner has the burden of proving, by clear and convincing evidence, that some part of the underpayment for the year was due to fraud. Sec. 7454(a); Rule 142(b), Tax Court Rules of Practice and Procedure; *Levinson v. United States* [74-1 USTC ¶ 9430], 496 F.2d 651 (3d Cir. 1974), cert. denied 419 U.S. 1040 (1974); *Estate of Pittard v. Commissioner*, 69 T. C. 391 (1977); *Estate of Temple v. Commissioner* [Dec. 34,083], 67 T. C. 143 (1976); *Imburgia v. Commissioner* [Dec. 20,493], 22 T. C. 1002 (1954); *Petit v. Commissioner* [Dec. 16,475], 10 T. C. 1253 (1948). To establish fraud, the Commissioner must show that the taxpayer intended to evade taxes, which he knew or believed he owed, by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes, *Stoltzfus v. United States* [68-1 USTC ¶ 9499], 398 F.2d 1002, 1004 (3d Cir. 1968), cert. denied 393 U.S. 1020 (1969); *Webb v. Commissioner* [68-1 USTC ¶ 9341], 394 F.2d 366, 377 (5th Cir. 1968), [Dec. 27,918(M)] affg. a Memorandum Opinion of

this Court; *Acker v. Commissioner*, 26 T. C. 107, 112-113 (1956). The presence or absence of fraud is a factual question to be determined by an examination of the entire record. *Mensik v. Commissioner* [64-1 USTC ¶ 9243], 328 F.2d 147, 150 (7th Cir. 1964), affg. [Dec. 35,804(M)] 37 T. C. 703 (1962), cert. denied 379 U.S. 827 (1964); *Otsuki v. Commissioner* [Dec. 29,807], 53 T. C. 96, 105-106 (1969). Since fraud can seldom be established by direct proof of intention, the taxpayer's entire course of conduct can often be relied on to establish circumstantially such fraudulent intent. *Stone v. Commissioner* [Dec. 30-767], 56 T. C. 213, 223-224 (1971); *Otsuki v. Commissioner, supra* at 105-106.

The Commissioner contends that the petitioner realized substantial income from swindling over a 5-year period, that the petitioner was aware of his obligation to file returns and to pay tax of such income, and that, with an intent to evade tax, he failed to do so. The petitioner presents several alternative arguments in response: First, that the funds he received were advances subject to repayment and therefore not income; second, that if such funds were income, they were the income of his father's company, H. Afshar and Company, and not his; and third, that if such funds were received by the petitioner, they were income from embezzlement, not swindling, and therefore the failure to report such income in 1958, 1959, and 1960 was inadvertent and not due to fraud.

The petitioner has stipulated that the funds he received from Fluor, Mr. Scruggs, Winkelman Co., JDP, Procon, Langenfelder & Son, Greiner Co., Brookhart & Tyo, Panama-Williams, and Missouri Valley constituted gross income in the year of receipt. However, such stipulation was not entered into until 1976. Such stipulation is binding for purposes of the deficiency, but it does not settle the question of fraud. For us to decide the issue of fraud, we must consider the petitioner's arguments and examine all the circumstances surrounding the receipt of

such income to decide whether the Commissioner has shown by clear and convincing evidence that the petitioner intended to evade tax which he knew or believed he owed.

Section 61 provides that gross income means all income from whatever source derived. It has long been established that gross income is broadly defined and that Congress intended "to use the full measure of its taxing power" under the 16th Amendment. *Helvering v. Clifford* [40-1 USTC ¶ 9265], 309 U.S. 331, 334 (1940). Whether there is an economic benefit accruing to the taxpayer is the crucial factor in determining whether there is gross income. *James v. United States* [61-1 USTC ¶ 9449], 366 U.S. 213 (1961); *Commissioner v. Glenshaw Glass Co.* [55-1 USTC ¶ 9308], 348 U.S. 426 (1955); *Rutkin v. United States* [52-1 USTC ¶ 9260], 343 U.S. 130 (1952). A loan or advance does not constitute income to the borrower, since the temporary economic benefit derived from the use of such funds is offset by the corresponding obligation to repay. *United States v. Rochelle* [67-2 USTC ¶ 9694], 384 F.2d 748, 751 (5th Cir. 1967), cert. denied 390 U.S. 946 (1968). However, where a "borrower" obtains funds by fraud or swindling, and where it is apparent that he recognizes no obligation to repay, the receipt of such funds constitutes income. They are income even though his freedom to use such funds may be assailed by someone with better title to them. *Rutkin v. United States, supra* at 137. As stated by the court in *Rochelle*:

> Were we to hold otherwise, confidence men could avoid the tax consequences of their transactions by merely adding a false promise to repay to their representations. Such a distinction between fraudulently obtained "loans" and fraudulently obtained outright grants is not tenable here [384 F.2d at 752.]

See *also McSpadden v. Commissioner*, 50 T. C. 478, 489-490 (1968).

It is clear from the record that the petitioner had no intention to repay the funds advanced to him and that he had the unrestricted use and benefit of such funds. The petitioner represented himself either as a man of influence with the officials in Iran who controlled the awarding of contracts, or as an envoy of the Iranian government in selecting contractors, or as the probable candidate for the position of Administrator of Public Works in Iran. After initiating his contact, the petitioner asked for an advance to cover the cost of bringing an Iranian negotiating team to the United States, or in the case of Mr. Scruggs, to Helsinki, to discuss the potential contract. Invariably, an unforeseen, but never precisely defined, "problem" developed which necessitated the expenditure of more funds than had been anticipated. Such request for additional funds usually came via a telephone call from Geneva. The funds were advanced, but the negotiating team never arrived or the deal did not go through. In not one situation did the petitioner obtain any business in Iran for the contractor, nor did he bring representatives from Iran, nor did he return any of the funds advanced except for those demanded by Mr. Scruggs. Although the mere failure to repay an advance is not evidence that there never was an intent to repay, the uniformity of his pattern of operations shows beyond a doubt that the funds were obtained under false pretenses. Also, the fact that the petitioner never utilized the funds "advanced" for their stated purpose, and in the case of Fluor, used such funds to settle a potential suit by Mr. Scruggs, clearly demonstrates that he had the unrestricted use and benefit of such funds. See *Rutkin v. United States, supra; United States v. Rochelle, supra; Leaf v. Commissioner* [Dec. 24,113], 33 T. C. 1093 (1960) [61-2 USTC ¶ 9695], affd. per curiam 295 F.2d 503 (6th Cir. 1961).

The petitioner testified that he still considers himself obligated to repay the funds "advanced" to him. Such testimony is simply too improbable for us to place any credence upon it. The transactions involved here oc-

curred 17 to 21 years prior to trial. According to the petitioner's testimony, after his father's death in 1963 or 1964, he succeeded to the presidency of H. Afshar and Company, a large and prosperous corporation. Clearly then, at least until 1967, the petitioner would have had the financial resources to repay some or all of the funds advanced to him; yet, he did not.

Having determined that the funds the petitioner received were income, we next consider his argument that such income was not his, but that of his father's company, H. Afshar and Company. The petitioner contends that, during the years in issue, he was in charge of H. Afshar and Company's U.S. operations. The only evidence supporting such contention is the petitioner's testimony. None of the individuals who dealt with him had any knowledge that he was working for anyone other than himself. Under such circumstances, we find the petitioner's testimony unworthy of belief. See *Potito v. Commissioner* [76-2 USTC ¶ 9494], 534 F.2d 49 (5th Cir. 1976), [Dec. 33,264 (M)] affg. per curiam a Memorandum Opinion of this Court, cert. denied 429 U.S. 1039 (1977); *Lovell & Hart, Inc. v. Commissioner* [72-1 USTC ¶ 9273], 456 F.2d 145, 148 (6th Cir. 1972), [Dec. 30,453] affg. per curiam a Memorandum Opinion of this Court; *Ruark v. Commissioner* [71-2 USTC ¶ 9699], 449 F.2d 311, 312 (9th Cir. 1971), [Dec. 29,491(M)], affg. per curiam a Memorandum Opinion of this Court; *Fleischer v. Commissioner* [68-2 USTC ¶ 9638], 403 F.2d 403, 406 (2d Cir. 1968), [Dec. 28,430(M)] affg. a Memorandum Opinion of this Court; *Glimco v. Commissioner* [68-2 USTC ¶ 9436], 397 F.2d 537, 540-541 (7th Cir. 1968), [Dec. 28,483(M)] affg. a Memorandum Opinion of this Court, cert. denied 393 U.S. 981 (1968).

What is more, the petitioner's testimony is contradicted by his claim of deductions for alleged business expenses. He has contended that he is entitled to business deductions for expenses he claims are related to the funds he

received. Yet, if the petitioner's relationship with H. Afshar and Company was as he states, any deductions would have been the company's and not the petitioner's. Thus, the petitioner's claim that such deductions were his own is utterly inconsistent with his argument that the income to which such deductions relate did not belong to him. Accordingly, we find and hold that the Commissioner has clearly proven that the income the petitioner received was taxable to him, and not to H. Afshar and Company.

The petitioner's next argument is that if the funds received by him were income, such funds were obtained by embezzlement; therefore, he contends that even if he failed to report and pay tax on such income, the *Wilcox* rule (*Wilcox v. Commissioner* [46-1 USTC ¶ 9188], 327 U.S. 404 (1946)) was in effect during 1958 through 1960, and therefore, any underpayment with respect to such income cannot form the basis for the imposition of the fraud penalty for such years. Although the petitioner may have correctly stated the law with respect to embezzled funds, he has improperly characterized the receipt of his illegally gotten gains.

In *Wilcox*, the Supreme Court held that the proceeds of embezzlement did not constitute taxable income to the embezzler, but *Wilcox* was overruled by *James v. United States*, 366 U.S. at 221-222. *James* has been applied retroactively to hold that the proceeds from embezzlement were taxable income (see *Geiger's Estate v. Commissioner* [65-2 USTC ¶ 9697], 352 F.2d 221 (8th Cir. 1965), [Dec. 26,825(M)] affg. a Memorandum Opinion of this Court, cert. denied 382 U.S. 1012 (1966)), but there is some doubt as to whether *James* should be applied retroactively to hold that the failure to report such income may alone be the basis for imposing the civil fraud penalty. See *Estate of Kahr v. Commissioner* [69-2 USTC ¶ 9594], 414 F.2d 621, 627 (2d Cir. 1969), [Dec. 28,617] affg., in part, on this ground 48 T. C. 929 (1967); *Adame's Es-*

tate v. Commissioner [63-2 USTC ¶ 9622], 320 F.2d 811 (5th Cir. 1963), revg. on this issue [Dec. 25,324] 37 T. C. 807 (1962); *McGee v. Commissioner*, 61 T. C. 249 (1973), affd. 519 F.2d 1121 (5th Cir. 1975), cert. denied 424 U.S. 967 (1976). In between *Wilcox* and *James*, the Supreme Court decided *Rutkin v. United States*, *supra*. *Rutkin* limited *Wilcox* to its facts and held that extorted funds did constitute taxable income to the extortionist. Thus, after the Supreme Court's decision in *Rutkin*, and prior to its decision in *James*, a taxpayer seeking to avoid the taxation of the income had to show that he acquired his illegal gains, through embezzlement, and not through fraud, extortion, false pretenses, or swindling. See *Rollinger v. United States* [53-2 USTC ¶ 9647], 208 F.2d 109 (8th Cir. 1953). In *Rollinger*, at 112, the court quoted with approval 29 C. J. S., Embezzlement, sec. 1, p. 671:

> "Embezzlement differs from swindling or obtaining money by false pretenses in that in embezzlement the property is fraudulently appropriated by the person to whom it had been intrusted, whereas in swindling the property is wrongfully acquired in the first instance by means of some false pretense or device."

See also *Akers v. Scofield* [48-1 USTC ¶ 9249], 167 F.2d 718, 719-720 (5th Cir. 1948), cert. denied 335 U.S. 823 (1948); *McGee v. Commissioner*, *supra* at 258; Perkins, Criminal Law, ch. 4, sec. 4, pp. 297-298, 306 (2d ed. 1969). Under such definition, it is clear that the petitioner did not acquire the funds he received by embezzlement, but rather by swindling or false pretenses.[6]

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[6] Compare sec. 503 (embezzlement) with sec. 532 (false pretenses), Cal. Penal Code (West 1970); compare sec. 207 (embezzlement) with sec. 253 (false pretenses), Ill. Ann. Stat., ch. 38 (Smith-Hurd 1935); compare sec. 129 (embezzlement) with sec. 140 (false pretenses), Md. Crim. Law Code Ann., art. 27 (1957); compare sec. 932 (false pretenses) with sec. 1290 (larceny), N.Y. Penal Law (McKinney 1944); compare sec. 4824 (embezzlement) with sec.

Hence, during all of the years in issue, the law was settled that the funds the petitioner received constituted income which he was required to report in the year of receipt. See *Rutkin v. United States, supra.*

What is more, even after the *James* decision, the petitioner did not report the funds received by him from the various contractors.[7] Such decision should have removed any doubt from his mind that such funds were taxable income in the year of receipt. His consistent failure to report such funds, both before and after *James* was decided, is convincing evidence that the petitioner was not relying on the possibility that such funds were not taxable prior to *James.* Rather, such failure is evidence that the petitioner was attempting to conceal his receipt of such funds with an intent to evade tax. *McGee v. Commissioner*, 61 T.C. at 260-261.

The mere failure to file tax returns, even over an extended period of time, does not in itself establish liability for additions to tax on account of fraud (*Marsellus v. Commissioner* [77-1 USTC ¶ 9129], 544 F. 2d 883, 885 (5th Cir. 1977), [Dec. 33,567(M)] affg. a Memorandum Opinion of this Court); but, such failure to file is persuasive circumstantial evidence of fraud and may properly be considered in connection with other facts in determining whether any underpayment of tax is due to fraud. *Stoltzfus v. United States* [68-2 USTC ¶ 9499], 398 F. 2d at 1005; *Beaver v. Commissioner* [Dec. 30,380], 55 T.C. 85, 93 (1970).

The petitioner testified that he filed returns for each of the years in issue. For the years 1958 through 1960, the petitioner contends that his returns were prepared

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4836 (false pretenses), Pa. Stat. Ann., tit. 18 (Purdon 1945); compare sec. 1534 (embezzlement) with sec. 1545 (swindling), Tex. Penal Code Ann., tit. 17 (Vernon 1953).

[7] The petitioner does not argue, nor do we find, that the funds he received during 1958 through 1960 were received under differing circumstances than the funds he received during 1961 and 1962.

by Siavoosh Kalaly, the head accountant of H. Afshar and Company. He contends that after he signed such returns, Mr. Kalaly mailed them to the IRS. For the years 1961 and 1962, the petitioner contends that "tentative" returns were prepared by his attorney, Mr. Swinburne, and that Mr. Swinburne filed such returns with the IRS. Based on his exhaustive searches in 1963 and 1964 and again in 1978 and 1979 that disclosed no returns filed by the petitioner for the years in issue, and on inconsistencies in the evidence offered by the petitioner, the Commissioner asks us to conclude that the petitioner did not file a return for any of the years in issue. We agree with the Commissioner.

The searches conducted by the Commissioner to determine if there was a record of returns filed by the petitioner were very thorough.[8] Although it is possible that one of the petitioner's returns could have been lost in the mails or by the IRS, the fact that such searches failed to disclose a filing for 5 consecutive years is convincing

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[8] The petitioner introduced into evidence a copy of his 1969 return. Such return was allegedly filed with the Service Center in Memphis, Tenn., the Service Center to which residents of Virginia filed their returns. The Commissioner did not direct a search request to the Memphis Service Center, nor did any of his searches disclose a return filed by the petitioner for 1969. Because of the failure to conduct such search and disclose such return, the petitioner would have us conclude that the Commissioner's searches were inherently defective. We find such argument to be a mere ruse.

The district offices and service centers to which the Commissioner's search requests were directed covered the geographic areas where the petitioner should have or might have filed a return. No search was conducted at the Memphis Service Center because the petitioner did not reside in Virginia prior to 1969, and therefore, the Commissioner had no reason to search a Virginia address for the petitioner. What is more, even if the petitioner had used a Virginia address on his returns for 1958 through 1962, such returns should have been filed with the Philadelphia Service Center. The Commissioner's search request directed to such service center failed to disclose a return filed by the petitioner for the years 1952 through 1967.

evidence that returns were not filed. However, there is strong additional evidence that the petitioner did not file a return for any of the years in issue.

In his affidavit, Mr. Kalaly stated that he filed the petitioner's 1958, 1959, and 1960 returns with the "U.S. Treasury Department, New Jersey." He further stated that such returns were filed during the month of February, and that copies of such returns were sent to the petitioner in the United States. The petitioner testified that he could not remember if he signed his 1958 return, but he believed that he signed his 1959 return. Yet, he also testified that during the years in issue he made only one trip to Iran each year in the month of March. At his meeting with the special agent on January 4, 1962, the petitioner stated that copies of his returns were in Iran. From such evidence, it would be necessary for us to believe that Mr. Kalaly prepared the returns in Iran, that the returns with copies thereof were mailed to the petitioner in the United States for his signature, and that the petitioner sent the original returns to Iran for Mr. Kalaly to file them and the copies to be retained there. Such explanation is highly implausible and constitutes additional evidence that the petitioner did not file returns for the years 1958 through 1960.

The returns allegedly filed by the petitioner for 1961 and 1962 were "tentative" returns. Such returns, if they were filed, were merely a Form 1040 showing the petitioner's name, his wife's name, a New Jersey address, the names of his dependents, and no information as to his income and deductions. The petitioner now admits that the filing of such tentative returns was inadequate. See *Schroeder v. Commissioner* [61-2 USTC ¶ 9531], 291 F. 2d 649 654 (8th Cir. 1961), [Dec. 22,541(M)] affg. a Memorandum Opinion of this Court, cert. denied, 368 U.S. 985 (1962). However, he contends that he filed his returns in such manner on the advice of Mr. Swinburne. Therefore, he argues that his failure to disclose his in-

come and deductions could not have been with an intent to evade tax.

The question of whether there has been good-faith reliance on advice of counsel is a question of fact. *United States v. Baldwin* [62-2 USTC ¶ 9644], 307 F. 2d 577, 579 (7th Cir. 1962), cert. denied, 371 U.S. 947 (1963). In order to justify his reliance on the advice of counsel, it is essential that the taxpayer make a full and honest disclosure of information sufficient for the preparation of a correct return. *United States v. Cox*, 348 F. 2d 294 [65-2 USTC ¶ 9532], 296 (6th Cir. 1965). Also, such reliance must be in good faith and not designed merely to provide a defense. See *Ginsburg v. Commissioner*, 13 B.T.A. 417, 421 (1928).

The reason given by the petitioner for filing tentative returns was that contract negotiations were pending as of the due dates for his 1961 and 1962 returns. He testified that if such contracts were finalized, the funds advanced to him would have been income to him, and not loans.[9] However, the explanation given by Mr. Swinburne is not consistent with that of the petitioner. In his affidavit and in the requests for extension of time to file the petitioner's 1962 return, Mr. Swinburne stated that his reason for filing tentative returns was that the petitioner was not able to produce sufficient records and information to file a completed return, particularly information with respect to the petitioner's deductions.[10] In view of the inconsistency between the explanations given by the petitioner and Mr. Swinburne, we are not

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[9] Such testimony is inconsistent with the petitioner's argument that the funds he received were not taxable to him, but rather to H. Afshar and Company.

[10] At least for 1962, Mr. Swinburne had to have been aware that the petitioner had received gross income in excess of the amount that required the filing of a return, since in that year he had endorsed checks from Greiner Co. payable to the petitioner or the petitioner's wife in the amount of $5,250.

convinced that the petitioner adequately informed his counsel, and consequently, the petitioner's failure to file proper returns cannot be justified by his alleged reliance on the advice of his counsel. See *United States v. Cox, supra*; *United States v. McCormick* [3 USTC ¶ 1187], 67 F. 2d 867, 870-871 (2d Cir. 1933), cert. denied, 291 U.S. 662 (1934).

The petitioner also testified that in connection with his criminal case for willful failure to file, he delivered copies of his returns for 1958 through 1962 to the district court in Newark, N.J. However, the petitioner did not secure copies of such court's records. He did subpoena the Justice Department's file for such case. Such file would presumably have contained copies of the petitioner's returns, but it only contained an unsigned copy of the petitioner's tentative return for 1962.

In summary, the evidence is overwhelming that the petitioner did not file returns for any of the years in issue and that the circumstances surrounding such failure to file strongly and unequivocally indicate an intention to avoid the payment of taxes. See *Powell v. Granquist* [58-1 USTC ¶ 9223], 252 F.2d 56, 60-61 (9th Cir. 1958); *Schwarzkopf v. Commissioner* [57-2 USTC ¶ 9816], 246 F.2d 731, 734 (3d Cir. 1957) [Dec. 21,835 (M)], affg. on this issue a Memorandum Opinion of this Court; *Estate of Hill v. Commissioner* [Dec. 31,897], 59 T. C. 846, 856 (1973); *Harper v. Commissioner* [Dec. 30,129], 54 T. C. 1121, 1139 (1970).

Another important indicium of fraud is the petitioner's evasive, uncooperative, and dilatory conduct during the course of the Commissioner's investigation. The rationale behind his concept is that such conduct tends to indicate an effort to conceal the true facts concerning income. See *Powell v. Granquist, supra*; *Irolla v. United States*, [68-1 USTC ¶ 9222], 182 Ct. Cl. 775, 781-782, 390 F.2d 951, 954-955 (1968); *Estate of Beck v. Commissioner* [Dec. 30,776], 56 T. C. 297, 365 (1971); *Stone v. Commis-*

sioner, 56 T. C. at 224; *Beaver v. Commissioner*, 55 T. C. at 93; *Vise v. Commissioner* [Dec. 23,226], 31 T. C. 220, 226 (1958), [60-1 USTC ¶ 9474] affd. 278 F.2d 642 (6th Cir. 1960); *Bennett v. Commissioner* [Dec. 22,950], 30 T. C. 114, 122 (1958). The petitioner contends that his failure to cooperate was on the advice of Mr. Swinburne. He contends that inquiries by the special agents of companies from which the petitioner was receiving funds were injuring his relationship with such companies and that an agreement was reached between Mr. Swinburne and the special agent that the petitioner would turn over the records requested in exchange for such agent ceasing any third-party inquiries. He further contends that the special agent breached such agreement and that he was advised by Mr. Swinburne that he should therefore not cooperate with the IRS. Our reading of the record discloses a different story.

At the April 19, 1962, meeting between the petitioner, Mr. Swinburne, and the special agent in charge of the investigation of the petitioner, it is possible that some agreement was reached that the special agent would forego the making of third-party contacts if the petitioner turned over the information required at such meeting, specifically copies of his income tax returns, a list of contacts and details as to advances, and the sources of funds deposited in his bank accounts. However, it is apparent that the requested information was not made available, and therefore, the special agent, frustrated in his attempts to examine the petitioner's returns and records, resorted to third-party inquiries.

Although the petitioner may have believed that he had an agreement with the special agent, it is clear that as of April 1963, Mr. Swinburne was aware that no such agreement was recognized by the special agent then in charge of the investigation. After such date, Mr. Swinburne repeatedly indicated that both he and the petitioner were attempting to assemble the petitioner's tax records.

Thus, unless Mr. Swinburne lied to the special agent or to his client, after April 1963, the petitioner was aware that no such agreement was in effect. Moreover, the petitioner's alleged efforts to obtain his tax records after such date are inconsistent with his contentions that he was advised not to cooperate with the IRS. In the light of all these circumstances, it is clear that the petitioner's conduct was merely an attempt to forestall the Commissioner's investigation and to mislead and conceal his income. As stated by the Court in *McGee v. Commissioner*, 61 T. C. at 260:

> While evidence that a taxpayer was attempting to defraud another in a business transaction may not be direct evidence of fraud with intent to evade tax, see *Toledano v. Commissioner* [66-1 USTC ¶ 9476], 362 F.2d 243, 247 (C. A. 5, 1966), the Court is entitled to consider such evidence along with other evidence in determining the intent of the taxpayer in doing certain acts, because it is a fair inference that a man who will misappropriate another's funds to his own use through misrepresentation and concealment will not hesitate to misrepresent and conceal his receipt of those same funds from the Government with intent to evade tax. *Rogers v. Commissioner* [40-1 USTC ¶ 9459], 111 F.2d 987 (C. A. 6, 1940). The legal relevancy of such evidence is based upon logical principles which go to negate innocent intent. *United States v. Bridell*, 180 F. Supp. 268 (N.D. Ill. 1960); *Pappas v. United States* [54-2 USTC ¶ 9637], 216 F.2d 515 (C. A. 10, 1954).

The evidence is overwhelming that by conduct intended to mislead and conceal his income the petitioner intended to evade tax which he knew or believed he owed. Consequently, for each of the years in issue, the Commissioner's assertion of an addition to tax for fraud is sustained.

Issue 3. Failure to Make Estimated Tax Payments: Section 6654

The final issue for decision is whether the petitioner is liable for an addition to tax, pursuant to section 6654, due to an underpayment of estimated tax for each of the years in issue. The imposition of this so-called penalty is mandatory, unless the petitioner can bring himself within one of the exceptions of section 6654(d). *Mitchell v. Commissioner* [Dec. 29,424], 51 T. C. 641, 648 (1969), revd. 430 F.2d 1 (5th Cir. 1970), [71-1 USTC ¶ 9451] revd. 403 U.S. 190 (1971); *Estate of Ruben v. Commissioner* [Dec. 24,109], 33 T. C. 1071, 1072 (1960). The petitioner has the burden of proof on this issue. *Estate of Ruben v. Commissioner, supra.*

We have already held that the petitioner is liable for deficiencies for 1958 through 1962. The petitioner's income for each such years was greatly in excess of the amount which required him to make estimated payments. The petitioner introduced no evidence that one of the exceptions of section 6654(d) applies. Accordingly, the Commissioner's determination on this issue is also sustained. See *Reaver v. Commissioner* [Dec. 26,736], 42 T. C. 72, 83 (1964).

To reflect the additional business expense deductions allowed the petitioner for 1961 and 1962,

Decision will be entered under Rule 155.

UNITED STATES TAX COURT

Docket No. 6099-72

NASSER G. AFSHAR,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the opinion of the Court filed May 18, 1981, and incorporating herein the facts recited in the Respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes and additions to the tax due from the petitioner as follows:

		Additions to Tax	
Year	Deficiency	Sec. 6653(b) I.R.C. 1954	Sec. 6654 I.R.C. 1954
1958	$73,250.18	$36,625.09	$2,047.04
1959	15,001.61	7,500.81	415.04
1960	45,489.89	22,744.95	1,267.67
1961	21,007.03	10,503.02	582.16
1962	21,762.23	10,881.12	603.02

/s/ Charles R. Simpson
Judge

Entered: Nov. 3, 1981

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 82-1095

NASSER G. AFSHAR,
Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

ORDER

Upon consideration of the appellant's petition for rehearing and suggestion for rehearing en banc, and no judge having requested a poll on the suggestion for rehearing en banc,

It is ADJUDGED and ORDERED that the petition for rehearing is denied.

Entered at the direction of Judge Butzner with the concurrence of Judge Phillips and Judge Haynsworth.

For the Court,

/s/ William K. Slate, II
Clerk

Filed Dec. 2, 1982

Office-Supreme Court, U.S.
FILED
APR 18 1983
ALEXANDER L. STEVAS,
CLERK

No. 82-1447

In the Supreme Court of the United States

OCTOBER TERM, 1982

NASSER G. AFSHAR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

In this federal income tax case, petitioner seeks review of the decision below holding that he is liable for deficiencies in tax and fraud penalties for the years 1958 through 1962.[1]

The pertinent facts may be summarized as follows: During the years in issue, petitioner represented himself to various construction and engineering firms as a person of influence in obtaining contracts with the government of Iran. Petitioner sought and received a total of $363,013.20 in "advances" from these firms, purportedly to cover his expenses in securing the Iranian contracts (Pet. App. 5a). Petitioner repeatedly made promises to bring Iranian negotiating teams to meet with firm representatives and to repay

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[1]The opinion of the court of appeals (Pet. App. 1a-2a) and its order denying a petition for rehearing filed by petitioner (Pet. App. 55a) are unreported. The findings of fact and opinion of the Tax Court (Pet. App. 3a-53a) are officially reported at 41 T.C.M. (CCH) 1489.

the advances he had received. None of the firms, however, obtained a contract or even a single negotiating session through petitioner's efforts (Pet. App. 42a). Moreover, petitioner failed to return virtually all of the funds advanced (*ibid.*). Instead, he used most of the funds for unauthorized personal expenditures (Pet. App. 9a, 11a, 42a) and he ignored repeated requests for repayment of the funds (Pet. App. 11a, 13a). The records of the Internal Revenue Service showed that petitioner filed no returns for the years in question (Pet. App. 47a-48a). On audit, the Commissioner issued a statutory notice of deficiency, including additions for fraud, based on the amounts received from the various corporations.

In this Tax Court proceeding, petitioner claimed that he had filed tax returns for the five years in issue (Pet. App. 46a-47a). He also contended that he incurred deductible business expenses in connection with the contracts he sought in Iran which offset his gross income with the result that he owed no tax for each of the years in issue (Pet. App. 29a). After hearing petitioner's testimony, the Tax Court found that petitioner had swindled the funds received from the ten firms (Pet. App. 3a, 41a-43a), that he did not file tax returns for the years in issue (Pet. App. 47a), and that his alleged offsetting business deductions did not exist (Pet. App. 32a-33a, 38a-39a).[2] As a result, the Tax Court determined that substantial deficiences existed in all years in issue (Pet. App. 3a-53a).

In addition, the Commissioner presented proof of petitioner's fraudulent intent, including the following indicia of fraud: (1) petitioner admitted to one of the firm representatives that "he always wanted everything paid to him outside

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[2]In his notice of deficiency, the Commissioner allowed petitioner more than $43,000 in business expenses (Pet. App. 30a). The Tax Court allowed petitioner additional deductible business expenses of $263.12 and $152.90 for the years 1961 and 1962, respectively (Pet. App. 33a).

the United States, so that he could evade this country's income taxes by concealing the money and not reporting the income" (A. 388);[3] (2) petitioner failed to file tax returns and, therefore, failed to report substantial amounts of income over a long period of time (A. 238-256, 355-362, 1025-1034); (3) petitioner refused to turn over records in his possession and repeatedly postponed meetings with revenue agents during the course of the Internal Revenue Service investigation (A. 271-275, 688-689); and (4) petitioner placed the funds advanced by his clients in a Swiss bank account where they would be concealed from the taxing authorities (A. 384, 392, 487-488, 516, 524-525, 635-637). The Tax Court found that the underpayments were due to fraud (Pet. App. 52a). Consequently, the Tax Court held petitioner liable for the 50% addition to tax under 26 U.S.C. 6553(b). The court of appeals affirmed (Pet. App. 1a-2a).

1. Petitioner argues (Pet. 9, 10-13) that both the Tax Court and the court of appeals adopted a standard requiring that the government prove only an "affirmative indication" to establish civil tax fraud (see *Stoltzfus* v. *United States*, 398 F.2d 1002, 1005 (3d Cir. 1968), cert. denied, 393 U.S. 1020 (1969)), and that this standard conflicts with decisions of other circuits that have employed an "affirmative act" standard. See *Jones* v. *Commissioner*, 259 F.2d 300, 303 (5th Cir. 1958); *First Trust & Savings Bank* v. *United States*, 206 F.2d 97, 99 (8th Cir. 1953). But even assuming *arguendo* that there is in fact a substantive difference between these two standards, it is clear that here the Tax Court employed the stricter affirmative act standard that petitioner would characterize as imposing a heavier burden on the Commissioner. The court stated that "* * *

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[3] "A." refers to the two-volume record appendix filed in the court of appeals.

the Commissioner must show that the taxpayer intended to evade taxes, which he knew or believed he owed, by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes" (Pet. App. 39a). It thereafter found that "by conduct intended to mislead and conceal his income the petitioner intended to evade tax which he knew or believed he owed" (Pet. App. 52a). As we have pointed out, this conclusion is amply supported by evidence of affirmative acts. Hence, it is plain that petitioner would be liable for the fraud penalty under either the affirmative act or affirmative indication standard. Thus, there is simply no basis for petitioner's assertion (Pet. 13) that this case "squarely presents the conflict" between the "affirmative act" and "affirmative indication" standards.[4]

2. Petitioner admits (Pet. 14 n.12) that he bore the burden of proving the validity of his claimed deductions insofar as the Commissioner's deficiency determination is concerned. He argues (Pet. 13-16), however, that insofar as the fraud penalty is concerned, the burden was on the government to show that petitioner's claimed deductions did not exist because the government is required to prove the existence of the amount of underpayment under 26 U.S.C. 7454(a).

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[4]Petitioner argues (Pet. 10) that the courts below implicitly adopted the affirmative indication standard because they upheld the Commissioner's fraud determination without requiring "any affirmative act of misrepresentation or fraud with respect to the taxing authorities." The record in this case, however, clearly established fraud under the arguably more stringent affirmative act standard. Petitioner's statement that "he always wanted everything paid to him outside the United States, so that he could evade this country's income taxes by concealing the money and not reporting the income" (A. 388), his refusal to give Internal Revenue Service investigators access to his records (A. 271-275, 688-689), his failure to report substantial amounts of income over an extended period of time (A. 238-256, 355-362, 1025-1034), and his deposits of swindled funds in a Swiss bank account (A. 384, 392, 487-488, 516, 524-525, 635-637) provide ample evidence of affirmative acts of fraud.

As the court of appeals here held (Pet. App. 1a-2a), petitioner's description of the burden of proof in the Tax Court is wrong. It is well established that the Commissioner's determination of tax liability is presumptively correct and places on the taxpayer both the burden of going forward with the evidence and the burden of persuading the court that it is erroneous. *Helvering* v. *Taylor*, 293 U.S. 507, 515 (1935); *Welch* v. *Helvering*, 290 U.S. 111, 115 (1933); T.C.R. 142(a) (May 1, 1979). Where, as here, petitioner failed to meet his burden of persuading the court that the Commissioner's determination was erroneous, the existence of the deficiency was then established as a fact.

Section 6653(b) provides that "[i]f any part of any underpayment * * * is due to fraud" the addition to tax shall be applied. The question then was whether any part of the deficiency was attributable to the taxpayer's fraudulent intent. A statutory exception to the general rule places the burden of proof on the issue of fraudulent intent on the Commissioner. See 26 U.S.C. 7454(a); T.C.R. 142(b) (May 1, 1979). The Commissioner is not required to prove the amount of the deficiency twice—once for the deficiency and once again for fraud. Indeed, although courts generally hold that the existence of substantial deficiencies, by itself, is insufficient to support a finding of fraud, where there is additional independent evidence of fraud, the existence of several substantial deficiencies—even where the finding of deficiencies was based on the taxpayer's failure to meet his burden of proof—will support a finding of fraud. See *Jackson* v. *Commissioner*, 380 F.2d 661, 664 (6th Cir. 1967); *Drieborg* v. *Commissioner*, 225 F.2d 216, 218-219 (6th Cir. 1955); *Estate of Beck* v. *Commissioner*, 56 T.C. 297, 363-364 (1971).

Moreover, as petitioner acknowledges (Pet. 14 n.14), even in criminal tax cases where the government has a higher burden of proof, a showing of unreported income

shifts to the taxpayer the burden to explain that omission, and where the taxpayer fails to meet that burden, the courts will find that an underpayment exists. *E.g., United States* v. *Hiett*, 581 F.2d 1199, 1202 (5th Cir. 1978); *United States* v. *Bender*, 218 F.2d 869, 871-872 (7th Cir.), cert. denied, 349 U.S. 920 (1955).[5] This rule is supported by basic rules of allocations of burdens of proof (see *McCormick's Handbook of the Law of Evidence* 787 (E. Cleary 2d ed. 1972)) and applies *a fortiori* in civil tax cases. *Rivera* v. *Commissioner*, 38 T.C.M. (CCH) 1338, 1344 (1979).

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[5]Accordingly, contrary to petitioner's argument (Pet. 14), the decision below does not conflict with *Sansone* v. *United States*, 380 U.S. 343, 351 (1965). That case held only that the existence of a deficiency is an element of criminal tax fraud. *Sansone* did not reach the issue of which party has the burden of proof with respect to offsetting deductions claimed by the taxpayer at trial.

Petitioner's reliance (Pet. 15, 16) on *Considine* v. *United States*, 683 F.2d 1285, 1286 (9th Cir. 1982), and *Goodwin* v. *Commissioner*, 73 T.C. 215, 229-231 (1979), is likewise misplaced. In *Considine*, the taxpayer stipulated that an underpayment existed and that he was only contesting the amount of the underpayment (683 F.2d at 1288). Hence, the court had no occasion to address the question whether the taxpayer in a civil fraud case has the burden of proving his entitlement to business deductions by clear and convincing evidence. Moreover, noting in *Goodwin* v. *Commissioner*, *supra*, is at variance with the rule employed by the court below imposing the burden of proof on petitioner with respect to the deficiency. There, the court held that the taxpayer's conviction for filing false income tax returns estopped him from denying that his returns were false and fraudulent for purposes of the civil fraud penalty. In this respect, the court concluded that the Commissioner "has shown by clear and convincing evidence that an underpayment of tax resulted from these understatements of income, *a part of which was due to fraud*" (73 T.C. at 231) (emphasis supplied). Hence, the court recognized that it was the existence of fraud as to which the Commissioner bore the burden of proof.

Finally, contrary to petitioner's claim (Pet. 15 n.14), the government's *Manual for Criminal Tax Trials* 65 (1973) does not contradict our position here that in a civil fraud case, the taxpayer has the burden of proving the existence of offsetting deductions. Because the income tax is computed on taxable income, the Manual merely instructs the

Here, the goverment's evidence established that petitioner obtained hundreds of thousands of dollars of income by swindling his clients, and that he failed to file tax returns reporting such income. In addition, the evidence established that he took affirmative steps to conceal these payments. The Commissioner in his notices of deficiency allowed petitioner more than $43,000 in deductible business expenses to offset a portion of petitioner's unreported income (Pet. App. 30a). Thus, the burden of going forward to show that the unreported income was further offset by additional deductions shifted to petitioner. The Tax Court found the petitioner's self-serving, uncorroborated testimony to be unworthy of belief (Pet. App. 33a, 38a-39a) and, therefore, found that petitioner had failed to make such a showing. Indeed, the imposition of the burden of proving his entitlement to the deductions is appropriately placed on petitioner since the underlying facts are peculiarly within his knowledge.

Finally, petitioner errs in asserting (Pet. 15) that the decision below conflicts with *Richardson* v. *Commissioner*, 264 F.2d 400, 404 (4th Cir. 1959). In *Richardson*, the taxpayers omitted certain income from their returns, but then proved to the trial court that they had made substantial deductible payments, also omitted from their returns, which were closely intertwined with the unreported income. The court expressly acknowledged that, under the general rule, the taxpayer bears the burden of proving unclaimed deductions, but made a limited exception to the rule under

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government's trial attorneys in a criminal tax evasion case to adduce proof of deductible expenses when the government has evidence of specific items of income omitted from tax returns. Nowhere does the Manual state that the government bears the burden of proving the nonexistence of additional deductions asserted by taxpayer at trial. For the convenience of the Court, we are lodging a copy of the pertinent section of the Manual with the Clerk.

the special facts before it. See 264 F.2d at 405. Unlike the taxpayers in *Richardson*, petitioner failed to establish that any of his records pertaining to his alleged expenses were business-related, for the Tax Court found his uncorroborated testimony to be unconvincing.[6] As a result, there was no reason for the courts below to depart from the general rule that the taxpayer has the burden of proving offsetting deductions asserted at trial.[7]

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[6]The Tax Court heard petitioner's testimony concerning the alleged seizure of his business records and concluded that "we are simply not convinced that the alleged books and records ever existed" (Pet. App. 39a). This is a factual finding that does not warrant further review. *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 214 (1948). Petitioner now claims (Pet. 4) that he has "recently learned" that our government told the Shah of Iran of a plan to "punish" petitioner by asserting tax deficiencies and violations against him. This claim is not based on the record of this case and, therefore, is entitled to no more weight than petitioner's bare assertions regarding the theft of his books and records.

[7]Petitioner contends (Pet. 16-20) that the Tax Court violated his rights to due process under the Fifth Amendment in quashing the subpoenas he served during the trial on various government agencies and departments. The subpoenas were served when the Tax Court trial was already in progress, and they required immediate production of all documents relating to petitioner's tax matters for the years 1957 through 1979. Petitioner sought to place this extraordinary burden upon the government in spite of the fact that he had had years in which to conduct discovery in this case and had studiously refused to do so even at the express admonition of the court. (See A. 95-96, 288, 317-318, 1231-1232.) Thus, there was no reason for the court to permit petitioner to conduct his discovery during the trial when petitioner had consciously refused to seek the documents or to retain counsel at the appropriate time.

Furthermore, while petitioner's counsel argued at trial that the subpoenas should not be quashed (although not on due process grounds) (A. 628), petitioner did not raise the issue either in his post-trial briefs in the Tax Court or in his briefs filed with the court of appeals. Petitioner presented the issue of the quashed subpoenas for the first time in his petition for rehearing, much too late for the issue to be considered a part of this case. Absent exceptional circumstances which are not present

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

APRIL 1983

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here, this Court will not consider issues not raised or passed upon in the lower court. *E.g., Youakim* v. *Miller*, 425 U.S. 231, 234 (1976); *Lawn* v. *United States*, 355 U.S. 339, 362-363 n.16 (1958); *Duignan* v. *United States*, 274 U.S. 195, 200 (1927).

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No. 82-1447

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Supreme Court of the United States

OCTOBER TERM, 1982

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITIONER'S REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

BRUCE J. ENNIS, JR.
(Counsel of Record)
GEOFFREY P. MILLER
ENNIS, FRIEDMAN, BERSOFF & EWING
1200 Seventeenth St., N.W.
Suite 511
Washington, D.C. 20036
(202) 775-8100
Counsel for Petitioner

May 5, 1983

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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PETITIONER'S REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

ARGUMENT

Respondent's Opposition to the Petition for Writ of Certiorari (hereafter Opp.) fails to rebut petitioner's arguments that the decision below conflicts with other decisions in the courts of appeals and raises an important and unsettled question of constitutional law.

1. *Conflict re: proof of an affirmative act of fraud.* Respondent does not even deny that there is a conflict among the circuits with respect to whether the Government must prove an "affirmative act" of fraud under 26 U.S.C. § 6653(b). Instead, respondent argues that the conflict is not presented on the facts of this case.

a. Respondent's suggestion that the court below applied the "affirmative act" standard is contrary to the record. Respondent cites the Tax Court's statements that "the Commissioner must show that the taxpayer intended to evade taxes, which he knew or believed he owed, by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes," and that "by conduct in-

tended to mislead and conceal his income the petitioner intended to evade tax which he knew or believed he owed." (Pet. App. 39a, 52a.) Those statements merely reiterate the obvious proposition that under § 6653(b) no taxpayer can be assessed civil fraud penalties unless conduct deemed to be fraudulent has occurred. Those statements do *not* say, however, that the indicia of fraud required to establish liability under § 6653(b) must include some *affirmative act* of deception of the taxing authorities. That the court below did not intend in those statements to adopt an "affirmative act" requirement is demonstrated by its reliance (Pet. App. 39a) on *Stoltzfus* v. *United States*, 398 F.2d 1002, 1004 (3d Cir. 1968), *cert. denied*, 393 U.S. 1020 (1969), the very case that expressly rejected the Eighth Circuit's "affirmative act" requirement in favor of a more lenient standard. Since the Tax Court cited for its statement of the governing rule an opinion that rejected an "affirmative act" standard, it obviously did not intend to adopt an "affirmative act" standard.

b. Respondent lists several statements and actions of petitioner's which, according to respondent, could meet the "affirmative act" requirement (Opp. at 4, n.4), but they are not entitled to any consideration in this Court because none of them was accepted by the Tax Court or the court below as having been proved at trial.

The only facts the court below accepted as establishing fraud were: (1) that petitioner's income was obtained under false pretenses; (2) that petitioner had been dilatory in providing information to the taxing authorities; and (3) that petitioner had failed to file returns for the years in question. These factual findings do not meet the "affirmative act" standard.

The Tax Court's conclusion that petitioner's income was obtained under false pretenses is legally irrelevant. Section 6653(b) requires fraud or misrepresentation with respect to the *taxing authorities*, and is not concerned with the sources of petitioner's income.

Similarly, petitioner's delay in providing the requested information was not an affirmative act of fraud. The Tax Court did not find that petitioner engaged in any misrepresentation or concealment with respect to the taxing authorities, or failed to comply with any IRS summons or judicial subpoena.[1]

Finally, petitioner's failure to file returns, even if willful, does not constitute an "affirmative act" of fraud. As the Eighth Circuit held in *First Trust and Savings Bank of Davenport* v. *United States*, 206 F.2d 97, 99 (8th Cir. 1953), civil fraud penalties are inappropriate where the taxpayer's dereliction "consisted only in wilful omission and passive neglect to perform the duty of making returns . . . ." *See also Jones* v. *Commissioner*, 259 F.2d 300 (5th Cir. 1958); *Marsellus* v. *Commissioner*, 544 F.2d 883, 886 (5th Cir. 1977).

The Tax Court did not find that the petitioner engaged in any "affirmative act" of misrepresentation or concealment with respect to the taxing officials. Accordingly, this case squarely presents the conflict between the Fifth and the Eighth Circuits, on the one hand, and the Third and Fourth Circuits, on the other, with respect to whether an "affirmative act" of fraud is a necessary prerequisite to liability under § 6653(b).

2. *Conflict re: burden of proof regarding deductions.* Respondent does not deny that the court below placed on petitioner the burden of proof with respect to the validity of petitioner's business deductions. Respondent argues, however, that the court below was correct in

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[1] Had the IRS wished to obtain tax information from petitioner, it could have issued a summons under 26 U.S.C. § 7602, and could have sought judicial enforcement, including civil contempt sanctions, if petitioner failed to comply. *See United States* v. *Rylander*, 51 U.S.L.W. 4367 (April 19, 1983). It would be inappropriate, when the IRS has not even tried to compel a taxpayer to provide information, to rely on the taxpayer's failure to volunteer information as a basis for imposing civil fraud penalties.

placing the burden of proof on petitioner, and that no conflict among the circuits exists with respect to this issue.

a. Respondent suggests (Opp. 5) that the issue is governed by cases such as *Helvering* v. *Taylor*, 293 U.S. 507 (1935) and *Welch* v. *Helvering*, 290 U.S. 111 (1933), which state that the Commissioner's determination of tax liability is presumptively correct and places on the taxpayer the burden of proving that the Commission's determination is erroneous. These cases, however, are entirely inapposite. Petitioner has never denied that he bore the burden of proving the validity of his claimed deductions insofar as the Commissioner's *deficiency* determination is concerned. But this case raises the quite different question of whether the taxpayer has the burden of proving the validity of claimed deductions in a *fraud* suit.

b. Respondent fails to rebut petitioner's argument that the circuits conflict on whether the Government has the burden of proving the invalidity of claimed deductions in a civil fraud case.

Respondent attempts to distinguish *Considine* v. *United States*, 683 F.2d 1285 (9th Cir. 1982) on the narrow factual ground that the validity of claimed deductions was not at issue in that case. However, the rule announced in *Considine* is clearly at variance with the decision below. The *Considine* court stated that "[t]o establish liability for . . . the civil fraud penalty, the Government must establish . . . an underpayment of tax," and held further that "[a]lthough the burden of proof is usually on the taxpayer in contesting a deficiency, the Government has the burden of proof to establish the elements of the civil fraud penalty by clear and convincing evidence." 683 F.2d at 1286 and n.1.

Similarly ineffective is respondent's attempt to distinguish *Richardson* v. *Commissioner*, 264 F.2d 400 (4th Cir. 1959). Respondent concedes that *Richardson* placed

the burden of proving the invalidity of deductions on the *Government*—a holding directly contrary to that of the court below. But respondent suggests that *Richardson* represents a "limited exception" to a general rule placing the burden on the taxpayer, applicable only to the "special facts" of that case. Opp. at 7-8. Respondent's attempt to distinguish *Richardson* on narrow factual grounds does not eliminate the basic conflict with the decision below.[2]

Finally, respondent fails to explain away (Opp. at 6, n.5) the conflict between the decision below and that of the Tax Court in *Goodwin* v. *Commissioner*, 73 T.C. 215, 229-31 (1979). *Goodwin* held that in a civil fraud suit the burden is on the Commissioner to prove by clear and convincing evidence that the taxpayer underpaid his taxes. After assessing the evidence of record, the court concluded that [the *Commissioner*] *has shown the amount of* [*the taxpayer's*] *deductible expenses* in each year here in issue." 73 T.C. at 230 (emphasis added). The Tax Court thus clearly placed the burden of showing the invalidity of claimed deductions on the Government, not the taxpayer—a result directly contrary to the decision of the court below.

c. The plain language of 26 U.S.C. §§ 7454(a) and 6653(b) establishes that in a fraud case, the burden of proof rests on the Government. Respondent, ignoring this plain language, reads § 7454(a) as stating that the Government has the burden of proof in fraud cases, but *only with respect to the taxpayer's fraudulent intent.* This qualification is not found in the language of

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[2] The *Richardson* court noted the Government's argument that "the burden of *going forward* in establishing the right to the deductions, was on the taxpayers," but the court placed on the Government the burden of *persuasion*, and ruled that "the Commissioner must prove that at least some unreported *net* income resulted from the unrecorded transactions" (264 F.2d at 405; emphasis added).

§ 7454(a), and respondent has not even claimed that such an important qualification can be inferred from the legislative history of that section.

d. Respondent does not deny that the elements of criminal and civil tax fraud are identical, or that a tax deficiency is one element of criminal tax fraud. *See Sansone* v. *United States*, 380 U.S. 343, 351 (1965). Unaccountably, however, respondent suggests that even in criminal fraud cases the burden is on the taxpayer to prove that a deficiency does not exist, and not on the Commissioner to prove that it does. That position is inconsistent with the basic principle that the Government must prove every element of an offense with proof beyond a reasonable doubt. *See Sandstrom* v. *Montana*, 442 U.S. 510 (1979); *In re Winship*, 397 U.S. 358 (1970).

A deficiency occurs when a taxpayer has received taxable income on which he has not paid tax. Taxable income is computed by subtracting deductions from adjusted gross income (and performing certain other calculations not relevant here). Thus, to establish a tax deficiency it is necessary to determine the amount of legitimate deductions.

In criminal tax fraud cases, therefore, one element of the Government's case is to show that a defendant does not have sufficient valid deductions to negate the existence of a deficiency. Since the elements of criminal and civil tax fraud are identical, the invalidity of the taxpayer's claimed deductions is also an element of the Government's *civil* tax fraud case. Accordingly, since under § 7454(a) the Government has the burden of proof in fraud cases, the Government in a civil tax fraud case has the burden of proving that claimed deductions are not valid.

Respondent's position is particularly puzzling in light of the contrary position taken in the Department of

Justice's own *Manual for Criminal Tax Trials* 65 (1973), which has been lodged with the Clerk. The *Manual* expressly states that:

> In order for direct evidence to be effective to establish further tax liability it must be such that it permits a finding by the jury that taxable income is understated. The tax is, of course, computed on the taxable income. In case, therefore, the government has evidence of specific items of income omitted from tax returns, *it must at the same time adduce proof of deductions, business costs and expenses, and exemptions.* (Emphasis added.)[3]

e. Respondent's argument that petitioner has the burden of proving the validity of claimed deductions confuses the concepts of burden of *persuasion* and burden of *production*.[4]

Petitioner has consistently argued that the court below erred in placing on petitioner the burden of *persuasion* with respect to the validity of claimed deductions. Peti-

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[3] Obviously, if the Fourth Circuit was led by the Government to believe that the burden of proof could constitutionally be placed on the taxpayer even in a criminal fraud case, it would not seriously have considered petitioner's additional argument that, in the circumstances of this civil fraud case, it would be unconstitutional to place the burden on the taxpayer. See Point 3, *infra*.

[4] Those concepts, although related, differ in practical and legal effect. The party bearing the burden of production (sometimes referred to as the burden of going forward with the evidence) has the task of introducing sufficient evidence to avoid a directed verdict, *i.e.*, enough evidence to allow a reasonable trier of fact to conclude that he is entitled to prevail in the suit. The party bearing the burden of persuasion, on the other hand, has the task of convincing the trier of fact that it is more likely than not that the facts entitle him to prevail in the litigation. The burden of production can be an issue throughout the trial, and may shift back and forth between the parties; the burden of persuasion comes into play only at the close of the case, and rests on the same party throughout the litigation. Ordinarily, the phrase "burden of proof" refers to the burden of persuasion, not the burden of production.

tioner has never contended that the burden of *production* was improperly allocated by the Tax Court. The taxpayer is almost always in a better position than the Government to introduce evidence concerning claimed deductions. Accordingly, it may be proper to place on the taxpayer the burden to come forward with some evidence as to the validity of his claimed deductions. However, the burden of persuasion on the issue of deductions should be on the Government, just as it is when the taxpayer meets his burden of coming forward with some evidence concerning his gross income.[5]

The distinction between the burdens of production and persuasion is not academic or hypothetical. Petitioner testified extensively and introduced documentary evidence in support of his claimed deductions. Accordingly, he clearly met his burden of production.

f. The cases cited by respondent for the proposition that the taxpayer has the burden of establishing the validity of claimed deductions in fraud cases in fact only place the initial burden of production on the taxpayer. *See* Opp. at 6 (citing *United States* v. *Hiett*, 581 F.2d 1199, 1202 (5th Cir. 1978) (". . . our holding in no way shifts the burden of proof to the [taxpayer]"); and *United States* v. *Bender*, 218 F.2d 869, 871-82 (7th Cir.), *cert. denied*, 349 U.S. 920 (1955) (the government's evidence had "the effect of shifting the burden of *going forward* with the evidence to the defendant." (Emphasis added)). Those cases recognize that the burden of *persu-*

[5] This allocation of the burdens of production and persuasion is similar to the allocation of the burdens of production (on the defendant) and persuasion (on the Government) in cases where a criminal defendant claims self defense or alibi. In all three situations the Government is, in a colloquial sense, required to prove a negative: that the defendant was not acting in self defense; that the defendant did not have an alibi; or that the taxpayer was not entitled to the deductions claimed. *See Mullaney* v. *Wilbur*, 421 U.S. 684, 702 n.30 (1975).

sion with respect to claimed deductions rests with the Government throughout.[6]

3. *The due process issue.* Respondent argues (Opp. at 8, n.6) that the due process issue should not be considered because it was raised "much too late for the issue to be considered a part of this case." However, the issue whether the Tax Court acted properly in quashing petitioner's subpoenas *was* raised below, and is properly presented for review.

Petitioner's counsel argued at trial that the subpoenas should not be quashed, and those arguments were rejected by the Tax Court. Petitioner also raised this issue, as respondent concedes, Opp. at 8, n.6, in his petition for reconsideration of the decision of the Court of Appeals. The Court of Appeals did not deny rehearing on the ground that the due process point stressed in the petition was raised too late. Instead, the Court of Appeals denied the petition on its merits. Accordingly, the due process argument was presented to the court below,[7] and respondent's suggestion that the due process issue is not properly presented to this Court for review is without merit.[8]

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[6] Of course, the Tax Court might have ruled against petitioner even if the burden of persuasion had been properly placed on the Government. But we have no way of knowing how the Tax Court would assess the facts of record based on a proper allocation of the burden of persuasion.

[7] The cases cited by respondent for the proposition that the due process issue is not properly presented to this Court are inapposite. Those cases involved issues that were neither presented to or decided by any lower court. In the present case, in contrast, the due process issue was presented below and was necessarily decided adversely to petitioner.

[8] Even the rule that this Court will not consider issues that were not presented to or passed on by the lower court is not inflexible. In appropriate circumstances, this Court has not hesitated to consider issues raised for the first time in the certiorari petition or jurisdictional statement. *E.g., Vachon* v. *New Hampshire*, 414 U.S. 478, 479 n.3 (1974); *Boynton* v. *Virginia*, 364 U.S. 454, 457 (1960);

CONCLUSION

This Court should grant the petition for a writ of certiorari.

Respectfully submitted,

BRUCE J. ENNIS, JR.
(Counsel of Record)
GEOFFREY P. MILLER
ENNIS, FRIEDMAN, BERSOFF & EWING
1200 Seventeenth St., N.W.
Suite 511
Washington, D.C. 20036
(202) 775-8100
Counsel for Petitioner

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Pollard v. *United States*, 352 U.S. 354, 359 (1957). Indeed, *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976) (per curiam), the principal case cited on this point by respondent, was a case where this Court decided an issue that was neither raised nor decided in the court below.